90-996

(1)

No. ———

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

COLORADO INTERSTATE GAS COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

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PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the court of appeals erred in holding that the Federal Energy Regulatory Commission, in a proceeding under Section 5(a) of the Natural Gas Act, could rely upon a policy change announced in a different and subsequent adjudicatory proceeding to shift the ultimate burden of persuasion to petitioner.

2. Whether the court of appeals erred in holding, contrary to the decision of the District of Columbia Circuit in *Transcontinental Gas Pipe Line Corp.* v. *FERC*, 907 F.2d 1211 (D.C. Cir. 1990), that a pipeline defending a minimum bill to its customer must demonstrate more than a "reasonable" connection between the pipeline's fixed cost minimum bill and the alleviation of take-or-pay liabilities that the pipeline has incurred.

3. Whether the court of appeals erred by upholding the Commission's order on the basis of a retroactive application of a policy that the Commission itself did not rely upon and in a way that deprived petitioner of a meaningful hearing.

LIST OF PARTIES

The parties to the proceeding below were: Colorado Interstate Gas Company, the Federal Energy Regulatory Commission, Natural Gas Pipe Line Company of America, the Gates Rubber Company, Questar Pipe Line Company, K N Energy, Inc., and the City of Colorado Springs.

Pursuant to Rule 29.1 of this Court, The Coastal Corporation and Coastal Natural Gas Company are identified as the parent corporations of Colorado Interstate Gas Company ("CIG"). CIG has no subsidiaries other than those it wholly owns.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner, Colorado Interstate Gas Company, respectfully requests that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Tenth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals is reported at 904 F.2d 1456 (10th Cir. 1990), and is included in the Appendix at pp. 1a-26a. The order of the court of appeals denying rehearing is included in the Appendix at pp. 27a-28a. Opinion No. 290 of the Federal Energy Regu-

latory Commission is reprinted at 41 FERC ¶ 61,179 (1987) and appears in the Appendix at 29a-62a. Opinion No. 290-A (opinion on the denial of rehearing) of the Commission is reprinted at 43 FERC ¶ 61,089 (1988) and appears in the Appendix at 63a-82a.

JURISDICTION

The judgment of the court of appeals was entered on May 31, 1990. Rehearing was denied on August 23, 1990. On November 9, 1990, Justice White extended the time for filing a petition for a writ of certiorari to and including December 21, 1990. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY AUTHORITY INVOLVED

Section 5(a) of the Natural Gas Act of 1938 provides:

> Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order . . . .

15 U.S.C. § 717d(a).

STATEMENT OF THE CASE

This case involves an appeal from a Federal Energy Regulatory Commission ("Commission") order eliminating the authority of natural gas pipelines to charge

their customers a fixed cost "minimum bill." A minimum bill allows pipelines to recover, at least in part, fixed costs incurred in constructing and maintaining pipeline facilities which provide service to their customers.[1] The minimum bill also serves to offset take-or-pay costs which pipelines incur in order to ensure supplies of gas sufficient to meet contractual obligations to their customers. In this specific case, the Tenth Circuit affirmed an order eliminating a fixed cost minimum bill by applying *retroactively* a new Commission presumption against fixed cost minimum bills, even though this shift in policy and procedure was announced in a separate Commission adjudicatory proceeding held long *after* the record was closed in this case. Even worse, according to the Tenth Circuit's interpretation of the new policy, the ultimate burden of persuasion shifted to petitioner to justify its minimum bill. To appreciate the fundamental unfairness of the Court's holding, an extended description of the case is warranted.

A. Factual Background

Petitioner, Colorado Interstate Gas Company ("CIG"), is a pipeline company that buys, transports and sells natural gas. CIG's pipeline begins in southwest Wyoming, runs East to Cheyenne, then turns south through Colorado and continues into the Oklahoma and Texas panhandles. At that point, CIG's pipeline connects with other major "trunk" lines that can carry the gas to the Midwest and elsewhere. Natural Gas Pipe Line Company of America ("NGPL") is also a pipeline company. It owns one of the pipelines that intersects with CIG's in Oklahoma, runs northeast from Oklahoma through Beatrice, Nebraska, and terminates in Chicago, Illinois, where NGPL sells to natural gas consumers.

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[1] Other traditional fixed costs include costs for production and gathering facilities, depreciation, taxes, return on equity, and carrying charges on debt.

Pursuant to a service agreement between CIG and NGPL, NGPL is a "partial requirements" customer of CIG. NGPL's status allows it to "swing off" CIG's system and purchase gas from other suppliers. Also contained in the service agreement, however, is a "firm entitlements" commitment, which requires CIG to stand ready to serve NGPL with a specified volume of gas each day. On an annual basis, that amount of gas comprises more than one-quarter of CIG's capacity. *Colorado Interstate Gas Co.*, 25 FERC ¶ 63,012 at p. 65,011 (1983), *aff'd in part & rev'd in part*, 27 FERC ¶ 61,315 (1984). CIG's gas is gathered and transported through a complex structure located in the Rocky Mountains of Colorado and Wyoming, and in Utah, Kansas, Texas and Oklahoma. CIG therefore incurs high fixed costs in ensuring that it can meet its commitment to NGPL. (*Colorado Interstate Gas Co.*, 35 FERC ¶ 63,043 at p. 65,145 (1986).

CIG's tariff contained a fixed cost minimum bill which allows CIG to charge NGPL a minimum amount for each billing period. This provision was designed to afford some protection to CIG and its other "full requirements" customers, who cannot swing off CIG's system. The risk is that CIG will not recover any fixed costs because NGPL will swing off the system and those costs will then be borne by CIG or by CIG's customers, even though they have not caused those costs to be incurred. In that event, the minimum bill is the only means by which CIG can fully recover the fixed costs it has incurred to service NGPL. Elimination of that minimum bill thus makes NGPL a "free rider" in the classic sense; the fixed costs NGPL would otherwise pay for its option to purchase CIG's gas are now shifted to CIG.

CIG's minimum bill serves one other important function: It reduces CIG's take-or-pay exposure. Pursuant to contracts CIG negotiated with gas suppliers during gas shortages in the 1970s, CIG is obligated to pay for large amounts of gas, whether or not CIG takes that

gas.[2] Such take-or-pay contracts are a major concern to the industry, and have been the focus of several Commission orders and several appeals. See generally *Mobil Oil Exploration and Producing Southeast, Inc.* v. *FERC*, 885 F.2d 209, 223, 234 (5th Cir. 1989), *cert. granted*, 110 S. Ct. 2585 (1990) (Nos. 89-1452, 1453). Because NGPL is a major partial requirements customer, CIG has entered into large take-or-pay contracts for supplies in order to meet NGPL's entitlements. See *Colorado Interstate Gas Co.*, 25 FERC at p. 65,019.

B. Related Commission Proceedings

1. In 1984, the Commission promulgated Order 380, which significantly modified all pipelines' use of minimum bills. Order 380 eliminated the variable cost portions of such bills, which meant, in essence, that pipelines could no longer charge their customers for the cost of natural gas that the pipelines had purchased but were not asked by those customers to deliver. The Commission did not, however, eliminate the fixed cost portion of minimum bills, and indeed, expressly refused to do so. See Order No. 380, FERC Stats. & Regs. (CCH) ¶ 30,571 at p. 30,965 (1984) ("the Rule adopted herein does not represent a departure from the traditional use of the minimum commodity bill to ensure greater fixed cost recovery"). Nor did the Commission find that minimum bills, in general, were anti-competitive; only those minimum bills with variable (not fixed) costs were deemed anticompetitive. Order No. 380-A, FERC Stats. & Regs. (CCH) ¶ 30,584 at p. 31,052 (1984). Hence, pipelines could continue to rely upon minimum bills as a means of collecting a portion of their fixed costs.

2. In a previous ratemaking order concerning the minimum bill in this case, the Commission gave its express approval to the fixed-cost component of CIG's minimum bill. See *Colorado Interstate Gas Co.*, 27 FERC

[2] CIG's obligation is subject to certain defenses, including force majeure and commercial impracticability.

¶ 61,315 at p. 61,583 (1984), *reh'g denied,* 28 FERC ¶ 61,083 (1984), *aff'd,* 791 F.2d 803 (10th Cir. 1986) ("We believe that a minimum commodity bill limited to recovery of the pipeline's fixed costs would be just and reasonable").[3] The Commission found that CIG was sufficiently dependent upon NGPL that a "fair and equitable remedy" warranted NGPL's payment of the fixed costs it had caused CIG to incur. See *Colorado Interstate Gas Co.,* 25 FERC at p. 65,021; 27 FERC at p. 61,683. The Commission also held that the minimum bill was the most appropriate and competitive means for CIG to recover its fixed costs because minimum bills do not guarantee recovery of all such costs. 27 FERC at p. 61,583. The Commission directed its staff to consider the appropriate level of fixed costs to be recovered in CIG's minimum bill when CIG next filed its rates. *Id.* The Tenth Circuit affirmed. *Colorado Interstate Gas Co.* v. *FERC,* 791 F.2d 803, 811 (10th Cir. 1986), *cert. denied,* 479 U.S. 1043 (1987).

3. CIG's next filing resulted in the orders at issue here. The Commission completely reversed field and decided that CIG would not be allowed to have a fixed-cost minimum bill at all. App. 60a. The Commission based its decison entirely upon two items in the record. App. 59a. The first item was testimony from an

[3] Pipelines may recover a demand charge from their customers in return for a reservation of capacity on their pipeline system. Demand charges include many of the fixed costs included in a minimum bill; the difference is that demand charges are paid whether gas is taken or not. Minimum bills are, of course, minimum charges that are paid *only* if the customer takes less than an agreed-upon amount of gas. These bills recover the remaining portion of the fixed costs in the commodity rate. In addition, minimum bills are most often limited to a specific percentage of the customer's contractual entitlement. CIG's minimum bill to NGPL required fixed costs payments if Natural took less than 90 percent of its contractual entitlement. The Commission gave its approval to CIG's use of a minimum bill despite the Administrative Law Judge's recommendation that fixed costs should be recovered in a demand charge rather than through the minimum bill.

NGPL witness to the effect that minimum bills, *in general*, were anticompetitive because "alternate supply sources must be priced lower than CIG's commodity rate by at least the amount of the minimum commodity bill before the two purchases are equally attractive to [NGPL]." *Id.* The Commission described the testimony as "sound theory" and relied upon that theory, coupled with the second item—a CIG official's statement that it was in a gas oversupply situation—to declare that the Commission staff had satisfied its burden of proof. *Id.*[4]

The record of these proceedings contains no evidence showing that CIG's minimum bill was operating in an unjust, unreasonable, and anticompetitive fashion. It was not contested that CIG's fixed cost minimum bill did not actually dictate NGPL's purchasing decisions or otherwise foreclose competition: NGPL stopped buying gas from CIG and had no plans to restart. In fact, NGPL bought gas from other suppliers at *higher* prices than CIG was charging and in quantities far greater than the volume covered by the minimum bill. As further evidence of the fact that CIG's minimum bill had in no sense "bound" NGPL to CIG as a supplier, CIG demonstrated that in 1984, prior to its tariff filing, CIG had given NGPL an opportunity to reduce or even eliminate its minimum bill. NGPL refused and renominated an amount of gas equal to more than one-quarter of CIG's capacity. The Commission thus eliminated CIG's minimum bill on the general assumption that minimum

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[4] Based on this "evidence," the Commission imposed upon CIG a modified fixed-variable ("MFV") rate design which placed the bulk of CIG's fixed costs "at risk" by allocating them to the variable commodity charge. While some fixed costs are allocated to a demand charge, see *supra* note 3, the MFV leaves all production and gathering fixed costs, all return on equity, and associated taxes in the commodity component. Under the Tenth Circuit's decision, those costs will be absorbed by CIG itself because NGPL continued to purchase no gas from CIG. App. 60a-62a.

bills have anticompetitive effects, in spite of CIG's evidence that its minimum bill had no anticompetitive effect.

C. The Court of Appeals' Ruling

The Tenth Circuit affirmed. App. 2a. In reaching this conclusion, the court acknowledged that the Commission's explanation for its decision "was rather meager." App. 7a. Accordingly, the court relied heavily on a Commission decision announced nearly two years afer the record was closed in the proceedings in this case. See *Transcontinental Gas Pipe Line Corp.*, 40 FERC ¶ 61,188 at p. 61,590 (1987) ("*Transco*"). In *Transco*, the Commission announced, for future cases, a new presumption that traditional fixed-cost minimum bills were an unreasonable restraint of trade. The Commission, the court said, "was entitled to rely on the presumption of anticompetitiveness established in [*Transco*]." App. 7a. Yet the court made no mention of the Commission's failure to rely upon the policy in *Transco* in entering the order under review. In addition, the court of appeals did not explain how the new policy announced in *Transco* could fairly be applied retroactively. In sum, the court declined to follow the FERC's own rationale, and what is worse, the court gave petitioner no opportunity to defend its minimum bill in light of the changed policy.

REASONS FOR GRANTING THE PETITION

The Tenth Circuit's decision eliminating CIG's minimum bill not only does violence to settled principles governing judicial review of agency decisions, but also is fundamentally unfair. The decision shifts the ultimate burden of proof to pipeline suppliers in minimum bill cases, contrary to express holdings by the D.C. Circuit and the Fifth Circuit. And it does so *after* the hearing has been completed. The decision creates a further, direct conflict with the D.C. Circuit on the issue of the nature of the evidence that is required to justify min-

imum bills. Accordingly, on review CIG has been held to a much more strict evidentiary requirement than that which applied when the record was created in this case and than would have been applied if this case had been brought in the D.C. Circuit.

Finally, the Tenth Circuit's decision is premised upon the retroactive application of a Commission shift in policy announced in a different adjudicatory proceeding. Contrary to this Court's settled precedent, the court did not remand to the Commission to determine whether retroactive application was, in the Commission's expert judgment, appropriate. Nor did the court, in the alternative, consider CIG's reliance upon the longstanding previous policy and the hardship such a *post hoc* policy change would impose; instead, the court affirmed on the basis of a rationale that was no part of either of the Commission's opinions. Egregious errors of this kind warrant summary reversal and remand by this Court.

1. The Tenth Circuit's opinion improperly allocates the ultimate burden of proof in these cases to the pipeline and thereby creates a conflict among the circuits concerning the proper interpretation of Section 5(a) of the Natural Gas Act, 15 U.S.C. § 717d(a). That Section provides that when, as here, the Commission initiates review of an existing and previously approved rate structure, the Commission must find that structure unjust or unreasonable and determine what the just and reasonable structure would be. Reviewing courts have consistently interpreted this language as placing the ultimate burden of proof on the Commission, or upon the parties opposed to the current rate structure. The theory behind such an allocation is simple: Having once found the existing rate structure to be just and reasonable, it is the Commission's burden to demonstrate that it is no longer so.

The Tenth Circuit, however, has fashioned a different rule. In its opinion, the court allocated the burden of ultimate persuasion to CIG rather than the Commission.

Although the panel recognized that Section 5(a) of the NGA places the burden squarely upon the Commission, the panel vitiated that requirement by holding that the Commission reasonably could "rely" upon a presumption against minimum bills which the Commission had announced in a separate adjudicatory proceeding which took place nearly two years after the record closed in this case. See *Transco,* 40 FERC at p. 61,590. Based on that policy, which could not in fact have informed the Commission's judgment, the court held that the burden properly shifted to petitioner. App. 4a-5a. This shift in the applicable burden of proof is contrary not only to the settled interpretations of Section 5(a),[5] but also to recent decisions of both the District of Columbia and Fifth Circuits in comparable minimum bill cases. See *Tennessee Gas Pipeline Co.* v. *FERC,* 871 F.2d 1099, 1104 (D.C. Cir. 1989); *Transwestern Pipeline Co.* v. *FERC,* 820 F.2d 733, 746 (5th Cir. 1987), *cert. denied,* 484 U.S. 1005 (1988).

In *Transwestern,* which involved similar legal issues,[6] the Fifth Circuit explained the proper allocation of the burden of proof in these cases:

> The burden placed on [the proponent of the minimum bill] was not a burden of persuasion. Trans-

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[5] E.g., *Sunray Mid-Continent Oil Co.* v. *FPC,* 364 U.S. 137, 144 (1960) (Commission would bear the burden of proof in an investigation under § 5 of the Act); *ANR Pipeline Co.* v. *FERC,* 771 F.2d 507, 513 (D.C. Cir. 1985) (same).

[6] The circumstances surrounding the elimination of Transwestern's minimum bill are instructive here. In *Transwestern Pipeline Co.,* 32 FERC ¶ 61,009 (1985), *reh'g denied,* 36 FERC ¶ 61,175 (1988), the Commission based its finding that Transwestern's minimum bill was anticompetitive upon the customers' showing that *Transwestern* was their high cost supplier, and that although they would have reduced their takes from it in favor of other suppliers, they could not because of the minimum bill. 32 FERC at p. 61,026. Here, CIG was not the high cost supplier and NGPL nevertheless reduced its takes to zero and purchased higher priced gas.

> western was not required to prove by a preponderance of the evidence that its minimum bills were justified. Rather, it was a burden of production under which Transwestern *was obligated merely to proffer justifications for its minimum bills.* The ultimate burden of proving competitive harm remained on the parties challenging Transwestern's minimum bills and seeking their elimination.

820 F.2d at 746 (emphasis added).

Similarly, the D.C. Circuit has stated plainly that "[t]he Commission . . . always retains the ultimate burden of proving that an existing minimum bill which the pipeline has not itself proposed to change is unlawful." *Tennessee*, 871 F.2d at 1104. The Tenth Circuit's decision, by contrast, creates a completely different allocation of burdens in Section 5(a) proceedings which, in a closely contested matter such as this one, is dispositive.[7]

Accordingly, had this appeal been brought in the D.C. Circuit or the Fifth Circuit, CIG would have been charged with only the burden of coming forward with some evidence of argument to demonstrate to show that its minimum bill was not operating in an anticompetitive fashion. CIG's undisputed evidence, that NGPL had not purchased and was not planning to purchase CIG's gas and that NGPL was in fact purchasing higher-cost gas

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[7] As explained at pp. 13-15 *infra*, a recent D.C. Circuit opinion vacated a Commission order eliminating a minimum bill on the ground that the Commission failed to demonstrate, on the basis of substantial evidence, that the proponents' minimum bill was unlawful. See *Transcontinental Gas Pipe Line Corp.* v. *FERC*, 907 F.2d 1211, 1214 (D.C. Cir. 1990) ("*Transcontinental Gas Pipe Line*"). Faced with a substantially similar issue in this case, the Tenth Circuit's allocation of the burden of proof to CIG ensured a different result from that in *Transcontinental Gas Pipe Line*. See App. 20a ("CIG has not adequately demonstrated its minimum bill was necessary to enable CIG to collect its take-or-pay costs").

from other suppliers,[8] satisfies that burden completely, especially when, as the court recognized here, a reviewing court's concern is whether a minimum bill has deprived a purchaser of its ability to choose among suppliers. See App. 10a-11a (citing *Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144, 1159 (D.C. Cir. 1985), *cert. denied*, 476 U.S. 1114 (1986)).[9]

The panel's unequivocal holding, therefore, is that CIG failed to prove ultimately that its minimum bill was not anticompetitive. The panel therefore ignored the Commission's complete failure to proffer any specific evidence of anticompetitiveness. This failure is manifestly wrong under Section 5(a) of the NGA and would have been rejected by the D.C. Circuit and the Fifth Circuit.[10] Accordingly, review by this Court is warranted.

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[8] The court of appeals itself cited testimony from an NGPL witness who admitted on cross-examination that NGPL was purchasing 2.5 to 3 times its entitlement from CIG at prices exceeding CIG's contract price ceiling. App. 10a.

[9] In the passage from the D.C. Circuit's opinion in *Wisconsin Gas*, which the Tenth Circuit quotes but quite clearly does not heed, the court explains that "the appropriate inquiry in assessing a minimum bill's effect on competition is 'not whether a particular pipeline will pursue a least-cost purchasing strategy, but is instead whether the customer will have the *ability* to do so.'" App. 10a-11a (quoting *Wisconsin Gas*, 770 F.2d at 1159). Whatever NGPL's idiosyncratic view of what constitutes a "least-cost strategy," see App. 11a n.11, the point is that the execution of that strategy in the form of purchases from alternate suppliers is indisputable proof that a purchaser has the *ability* to do so. Thus, by its own statement of the test to be applied with respect to this issue, the Tenth Circuit's concerns about NGPL's "other possible motives" was misplaced.

[10] Aside from the conflict in the lower courts which the decision below creates, the Tenth Circuit's opinion in this case warrants review, and reversal, for another reason: The court based its decision entirely upon a rationale that is no part of either of the Commission's orders. Such a ruling flatly violates this Court's holding in *SEC* v. *Chenery Corp.*, 332 U.S. 194, 196 (1947). See also *FPC* v. *Texaco Inc.*, 417 U.S. 380, 397 (1974) ("[A]n agency's order must be upheld, if at all, 'on the same basis articulated in the

2. The Tenth Circuit's opinion squarely conflicts with a recent D.C. Circuit decision concerning the evidentiary requirements applicable in minimum bill cases. Pursuant to a judicially created doctrine, a pipeline may justify a minimum bill even if that minimum bill is found to have anticompetitive effects. See *Atlantic Seaboard Corp.*, 38 FPC 91, 95 (1967), *aff'd, Atlantic Seaboard Corp.* v. *FPC*, 404 F.2d 1268 (D.C. Cir. 1968). That is possible when, *inter alia*, the pipeline can demonstrate that the minimum bill reduces the pipeline's take-or-pay exposure. See *Transwestern*, 820 F.2d at 743.

Under a take-or-pay contract with its own supplier, a pipeline is obligated to pay for a contractually fixed amount of gas, whether or not the pipeline actually takes that gas. Thus, when a pipeline's partial requirements customers swing off its line, the pipeline must pay for gas it does not take, unless it can somehow sell that gas to other customers. Take-or-pay contracts are a phenomena of the severe gas shortages of a decade ago, when producers were able to force pipelines to enter into such contracts with long-term conditions in order to secure adequate supplies for resale to their own customers. Hence, these contracts remain a problem in the industry today.

A minimum bill therefore can be justified as a means to recover equitably take-or-pay costs from all customers. *Id.* Consumer protection is the goal, inasmuch as the elimination of a pipeline's minimum bill would mean the passthrough of take-or-pay costs to customers who were not responsible for and receive no benefit from the pipeline having incurred those costs. See *Consolidated Gas Transmission Corp.* v. *FERC*, 771 F.2d 1536, 1541 (D.C. Cir. 1985). This result is not only inequitable, it violates the basic cost-causation principle of ratemaking

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order by the agency itself' ") (quoting *Burlington Truck Lines, Inc.* v. *United States*, 371 U.S. 156, 168-69 (1962)). See pp. 16-19, *infra*.

as well. *Alabama Elec. Coop.* v. *FERC*, 684 F.2d 20, 27 (D.C. Cir. 1982).

Here, CIG demonstrated that NGPL's nominations of large amounts of gas caused CIG to enter into at least two specific take-or-pay contracts. *Colorado Interstate Gas Co.*, 25 FERC ¶ 63,012 at p. 65,019 (1983). Nevertheless, the panel rejected CIG's argument, holding that CIG failed to provide adequate proof of a "specific connection" between the minimum bill issued and take-or-pay liability. App. 18a.

In *Transcontinental Gas Pipe Line*, 907 F.2d at 1214,[11] by contrast, the D.C. Circuit held that it was sufficient for the pipeline to show that given the large amount of take-or-pay liability incurred by the pipeline, a minimum bill would reduce that liability as a matter of common sense. The court did not require that the evidence demonstrate some "specific connection" between a particular minimum bill and take-or-pay liability stemming from a particular contract. Moreover, the *Transcontinental Gas Pipe Line* court was careful to point out that "[i]n order to invalidate the minimum bill *the Commission* must find, based on *substantial evidence*, that the bill is unlawful." 907 F.2d at 1214 (citing Natural Gas Act § 19(b), 15 U.S.C. § 717r(b) (first emphasis added, second in original); *East Tennessee Natural Gas Co.* v. *FERC*, 863 F.2d 932, 938 (D.C. Cir. 1988)).

The Tenth Circuit's holding (that CIG had failed to adduce any specific evidence of linkage) thus creates a circuit split and violates § 19(b) of the Natural Gas Act.

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[11] Although the D.C. Circuit's decision in *Transcontinental Gas Pipe Line Corp.* involved the same pipeline and the same minimum bill that was the subject of the Commission's *Transco* opinion (Opinion No. 260-A) (announcing that minimum bills are presumptively anticompetitive), the D.C. Circuit did not vacate Opinion 260-A. The opinion that the court of appeals did vacate, however, was one which eliminated Transco's minimum bill on the basis of Opinion 260-A. See 44 FERC ¶ 61,216 at pp. 61,805-06 (1988).

Moreover, the Tenth Circuit (as well as the Commission and the ALJ) also ignored the record in these proceedings: Aside from evidence concerning the two large take-or-pay contracts that CIG had entered into in order to satisfy its obligation to NGPL, at least two CIG witnesses testified that, because of the high percentage of CIG's gas supplies subject to take-or-pay contract provisions, substantial reductions in sales volumes would result in increased take-or-pay liability for CIG.[12] Thus, the logic applied by the D.C. Circuit in *Transcontinental Gas Pipe Line* should have been applied in this case: NGPL, as CIG's largest partial requirements customer, is contractually entitled to an amount of gas that constitutes more than one-quarter of CIG's capacity. In order to obtain gas to satisfy this obligation, CIG entered into two large take-or-pay contracts. Thus, once NGPL stopped taking CIG's gas altogether, CIG necessarily incurred some take-or-pay liability, either from take-or-pay contracts negotiated to fulfill its obligations to NGPL, or if it took gas under those contracts, from one of its other take-or-pay contracts. Under the ruling in *Transcontinental Gas Pipe Line*, this showing suffices to permit enforcement of the minimum bill. By contrast, the Tenth Circuit, in effect, eliminated one of the *Atlantic Seaboard*

[12] Mr. J.S. Charles, CIG's Vice-President of Marketing, observed in his direct testimony (Exh. 37, p. 4) that: "Since our jurisdictional rates are designed on those [certified] contract demand levels, if one of our customers buys less than design volumes from CIG because the customer has found another gas supplier, CIG or its other customers must bear the underrecovery and resulting liability to producers for take-or-pay." Mr. Kenneth B. Johnston, a consultant to CIG, testified in his direct testimony (Exh. 41, p. 4) that with respect to CIG, "take-or-pay obligations generally vary inversely with sales volumes." Finally, in Exhibit 137(A) to the rebuttal testimony of George Lewis Donkin, Mr. Kenneth M. O'Connell, CIG's Senior Vice President of Gas Supply and Marketing, explained that CIG had begun renegotiations with all of its suppliers because "we were deficient in our takes on all contracts on the system, and there was exposure to take-or-pay on those contracts" (p. 7).

justifications. The practical importance of these conflicting holdings, in light of the persistence of take-or-pay contract problems in the natural gas industry, warrants this Court's review.

3. The court of appeals' decision retroactively applies a new Commission presumption that all minimum bills, even those strictly limited to fixed costs, are anticompetitive. The Commission announced that presumption in a different adjudicatory proceeding which took place nearly two years after the record had closed in this case. The court of appeals' failure to remand to the Commission to determine whether retroactive application was appropriate constitutes such a profound departure from proper judicial review under *SEC* v. *Chenery Corp.*, 332 U.S. 194, 196 (1947), and its progeny, that it invites summary reversal and remand by this Court.

When an administrative agency reverses course with respect to a particular policy, this Court has declared that a reviewing court "should remand to permit the agency to decide in the first instance whether giving the change retrospective effect will best effectuate the policies underlying the agency's governing act." *NLRB* v. *Food Store Employees*, 417 U.S. 1, 10 n.10 (1974). That is especially true when, as here, the agency argues before the appellate court for retroactive application of its intervening change, but the agency decision announcing that change specifies that the new policy should be applied "*in the future.*" *Transco*, 40 FERC ¶ 61,188 at p. 61,590 (1987) (emphasis added). At a minimum, reviewing courts should not be free to ignore factors such as the parties' reliance on the previous policy, the importance of retroactive application to the policy's goals, and the hardship imposed by the retroactive application of a particular policy. See *Chevron Oil* v. *Huson*, 404 U.S. 97, 106-07 (1971); *Shell Oil* v. *Andrus*, 591 F.2d 597, 605 (10th Cir. 1979), *aff'd*, 446 U.S. 657 (1980) (citing *Logan* v. *Davis*, 233 U.S. 613 (1914)). The

Tenth Circuit, however, ignored all of these factors in approving the elimination of CIG's minimum bill.

These factors weigh heavily in favor of not applying the presumption retroactively in this case. Prior to Opinions 290 and 290-A, CIG's minimum bill had been in place, with Commission approval, since 1958. App. 58a.[13] Moreover, it is CIG's only minimum bill, because NGPL has been CIG's only major partial requirements customer. NGPL's ability to swing off CIG's system made it necessary for CIG to find some way to guarantee, at least in part, recovery of the fixed costs incurred to provide service to NGPL. Later, the minimum bill also served as a means for CIG to offset take-or-pay liability CIG incurred in order to secure enough gas to meet NGPL's nomination.

The panel's failure to remand to the Commission to determine the propriety of applying the policy retroactively, and its further failure to undertake its own assessment of the effects of retroactive application, are errors that are so obvious and render the process so fundamentally unfair that, at a minimum, the Court should vacate the judgment and require that these issues be decided on a complete record addressed to the correct issue.[14] Such a disposition would eliminate the need to review the conflicts among the circuits that the Tenth Circuit's opinion otherwise creates on the issues of the proper allocation of burdens of proof in NGA Section 5(a) hearings and the evidentiary requirement which pipelines must meet in

[13] "[T]he longer and more consistently an agency has followed one view of the law, the more likely it is that private parties have reasonably relied to their detriment on that view." *Clark Cowlitz Joint Operating Agency* v. *FERC*, 826 F.2d 1074, 1082-83 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 913 (1988) (citing *Hanover Shoe, Inc.* v. *United Shoe Machinery Corp.*, 392 U.S. 481, 495-502 (1968)).

[14] The Tenth Circuit's violation of the rule in *Chenery* by concocting its own rationale for the Commission's orders also warrants this result. See *supra* note 10.

order to justify their minimum bills under the *Atlantic Seaboard* tests.

Without doubt, administrative agencies must be free to make changes in their policies to account for changed industry circumstances or revised regulatory goals, so long as the agency gives a reasonable explanation for its changes. See *Motor Vehicle Mfrs. Ass'n* v. *State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 42 (1983); *Chenery*, 332 U.S. at 202-03. But deference to agency actions cannot be so complete that reviewing courts and the agencies themselves may simply choose to ignore complex issues of retroactivity presented by the shifting sands of agency policy. The Tenth Circuit's ruling in this case indicates that this Court needs to enforce the requirements of *Chenery* and *Food Store Employees* that a fundamental issue such as retroactivity must, at a minimum, be expressly addressed by the agency itself.

None of the factors which commonly govern retroactivity questions has played any part in either the Commission's or the court's decision in this case. What is more, the panel forgave the Commission's inability to prove that the fixed cost bill in this case was anticompetitive and deprived CIG of any opportunity to adduce evidence which would demonstrate that its bill in fact serves procompetitive policies.[15] In sum, the decision of the court of appeals rendered the hearing meaningless.

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[15] CIG might have adduced evidence to show, for example, that the presence of its pipeline in the particular areas also served by NGPL's "Trailblazer" system provided low-priced competition which benefitted consumers. In addition, CIG might also have adduced evidence to show that, without a minimum bill, but with significant entitlements under the service agreement, NGPL has obtained a competitive advantage by regulatory device. If firms like NGPL, which cause CIG to incur fixed costs in order to provide service, cannot be made to pay their fair share of those fixed costs, CIG must shift the extra burden onto its full requirements customers or shoulder the extra burden itself. CIG and its other customers are thus forced to give NGPL a "free ride" and to absorb its inefficiencies.

CONCLUSION

The petition for writ of certiorari should be granted. Alternatively, the Court may wish to vacate the judgment and require that the Commission, in the first instance, address the retroactivity issue after a full hearing.

Respectfully submitted,

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December 21, 1990

APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

No. 88-1932

COLORADO INTERSTATE GAS COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent,

THE GATES RUBBER COMPANY; QUESTAR PIPELINE COMPANY; K N ENERGY, INC.; CITY OF COLORADO SPRINGS; NATURAL GAS PIPELINE COMPANY OF AMERICA,
Intervenors.

May 31, 1990

William W. Brackett (Rebecca N. Noecker, Vice President and Asst. Gen. Counsel, Colorado Interstate Gas Co., Colorado Springs, Colo.; Daniel F. Collins, Sr. Vice President, Donald C. Shepler, Gen. Atty., and Kathrine L. Henry, Sr. Atty., Colorado Interstate Gas Co., Washington, D.C., with him on the briefs), Washington, D.C., for petitioner.

Robert H. Solomon, Atty. (Catherine C. Cook, Gen. Counsel, and Jerome M. Feit, Sol., with him on the briefs), Federal Energy Regulatory Com'n, Washington, D.C., for respondent.

Paul Korman (Paul W. Mallory, Paul E. Goldstein, and Joseph M. Wells, Lombard, Ill.; and J. Curtis Mof-

fatt of Gardner, Carton & Douglas, Washington, D.C., with him on the briefs) Washington, D.C., for intervenor.

Before LOGAN and BRORBY, Circuit Judges, and BRATTON,* District Judge.

BRORBY, Circuit Judge.

Petitioner Colorado Interstate Gas Co. (CIG) appeals two final administrative orders of the Federal Energy Regulatory Commission (FERC, or Commission) relating to the rates CIG may charge for the sale and transportation of natural gas. Specifically, CIG asserts FERC erred in ordering the elimination of the fixed-cost minimum commodity bill provision in CIG's service agreement with Natural Gas Pipeline Co. of America (NGPL) and in rejecting CIG's proposed transportation rate for "on-system" service.[1] We affirm the challenged portions of the FERC orders.

This proceeding originated when CIG, an interstate natural gas pipeline company subject to the Natural Gas Act, 15 U.S.C. §§ 717-717w, filed with FERC a rate increase request under section 4 of the Act, 15 U.S.C. § 717c. FERC ordered a hearing on the lawfulness of the proposed rates, which was conducted by a FERC administrative law judge (ALJ). The Commission subsequently affirmed in substantial part the ALJ's initial decision in Opinion No. 290, *Colorado Interstate Gas Co.*, 41 FERC ¶ 61,179 (1987), and then denied rehearing in Opinion No. 290-A, *Colorado Interstate Gas Co.*, 43 FERC ¶ 61,089 (1988). At issue in this appeal are FERC's holdings that the fixed-cost minimum commodity

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* The Honorable Howard C. Bratton, Senior Judge, United States District Court for the District of New Mexico, sitting by designation.

[1] Three other issues asserted in CIG's Opening Brief have been mooted by subsequent developments and were relinquished by CIG prior to oral argument in the case.

bill in CIG's service agreement with NGPL was anticompetitive and must be eliminated and that CIG's proposed on-system transportation rate is unjust and unreasonable.[2]

Under CIG's contract with NGPL, NGPL is entitled to buy a specified quantity of natural gas (currently 47 billion cubic feet (Bcf) per year) from CIG, and CIG must stand ready to deliver that quantity. The first issue in dispute is the contract's minimum bill provision, which requires NGPL to pay the commodity costs associated with ninety percent of its annual entitlement, even if it takes delivery of no gas from CIG.[3] CIG recovers from NGPL approximately $15 million annually in production and gathering costs via the minimum bill and $9 million annually collected through a demand charge. FERC ruled that the minimum bill is anticompetitive, and thus

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[2] This opinion deals with one of four petitions for review of these FERC orders which were filed in this court. An opinion in *Natural Gas Pipeline Co. of America v. FERC,* 904 F.2d 1469 (10th Cir. 1990), is also being filed today. Two other suits, Nos. 88-2191 and 88-2784, were dismissed by the parties prior to argument.

[3] CIG's (and most pipelines') sales rates consist of two parts: A demand charge, which recovers a portion of fixed costs, is paid on all contracted volumes, regardless of the amount of gas actually purchased. The commodity charge, which covers remaining costs and all variable costs, is paid only for volumes of gas actually sold. Variable costs consist principally of the cost of the gas itself, while fixed costs (at issue in this case) include production and gathering costs and the return on equity and certain associated taxes. FERC ruled in 1984 in Opinion No. 380 that the collection of variable costs through minimum bills is not just and reasonable.

The contract in issue here originally required NGPL to pay the full contract price for 90% of its entitlement, but after Opinion No. 380 was issued, FERC modified the minimum bill provision to eliminate the recovery of all variable costs. This court reviewed FERC's modification of CIG's minimum bill in *Colorado Interstate Gas Co. v. FERC*. 791 F.2d 803 (10th Cir. 1986), *cert. denied*, 479 U.S. 1043, 107 S.Ct. 907, 93 L.Ed.2d 857 (1987). In this case CIG objects to FERC's attempts to eliminate the minimum bill altogether and to limit the fixed costs otherwise recoverable by CIG.

unjust and unreasonable, and ordered that it be eliminated. This would limit to the demand charge alone CIG's guaranteed recovery from NGPL of fixed costs incurred on NGPL's behalf. FERC also ruled that CIG failed to bear its burden of proving the justness and reasonableness of its proposed rate increase for on-system transportation. The agency accordingly rejected CIG's request and ordered refunds for the period the proposed rate had been in effect.

We review these decisions pursuant to 15 U.S.C. § 717r. The factual findings of FERC, if supported by substantial evidence, are conclusive. Section 717r(b); *Colorado Interstate Gas Co. v. FERC*, 791 F.2d 803, 807 (10th Cir.1986), *cert. denied*, 479 U.S. 1043, 107 S.Ct. 907, 93 L.Ed.2d 857 (1987) (*CIG I*). Moreover, under the Administrative Procedure Act, a court can set aside an agency action only if it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A); *cf. In re Permian Basin Area Rate Cases*, 390 U.S. 747, 790, 88 S.Ct. 1344, 1372, 20 L.Ed.2d 312 (1968) (FERC's orders "may not be overturned if they produce 'no arbitrary result' "). The "substantial evidence" test has been equated with the "arbitrary and capricious" standard of review. *East Tenn. Natural Gas Co. v. FERC*, 863 F.2d 932, 937 (D.C.Cir. 1988) (*East Tennessee*) (quoting *Maryland People's Counsel v. FERC*, 761 F.2d 768, 774 (D.C.Cir. 1985)).

The burden of proving that a rate change is "just and reasonable," 15 U.S.C. §§ 717c-717d, is on the party proposing the change. *CIG I*, 791 F.2d at 806; *East Tennessee*, 863 F.2d at 937. When FERC initiates review on an existing rate structure, it bears the burden of proving that the existing rates are unjust and unreasonable and that those it orders in replacement are just and reasonable. 15 U.S.C. § 717d(a); *East Tennessee*, 863 F.2d at 937. Once it makes these prima facie showings,

the burden shifts to the opposing party to rebut them. *E.g., Transwestern Pipeline Co. v. FERC*, 820 F.2d 733, 746 (5th Cir. 1987), *cert. denied* 484 U.S. 1005, 108 S.Ct. 696, 98 L.Ed.2d 648 (1988).

We find it unnecessary to detail much of the background of this case—the purposes of the Natural Gas Act, the procedural history of this action, and the nature and workings of CIG's rate structure and the elements thereof—as these exercises have been performed adequately by this court or others on various occasions. *See, e.g., CIG I*, 791 F.2d at 805 (describing the early procedural history of this case and CIG's minimum bill provision); *Associated Gas Distributors v. FERC*, 824 F.2d 981, 995-96 (D.C.Cir.1987), *cert. denied* 485 U.S. 1006, 108 S.Ct. 1468, 99 L.Ed.2d 698 (1988) (describing purposes of the Act and the evolving regulatory climate); *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144, 1149-53 (D.C.Cir.1985), *cert. denied*, 476 U.S. 1114, 106 S.Ct. 1968, 90 L.Ed.2d 653 (1986) (discussing the operation of minimum bills generally, how FERC policy with respect to minimum bills has evolved in response to changes in the gas industry, and FERC's statutory authority); *Mississippi River Transmission Corp. v. FERC*, 759 F.2d 945, 947-50 (D.C.1985) (discussing minimum bills). Thus we proceed with our discussion of the issues.

I. The Minimum Bill

CIG claims that minimum bills are just and reasonable generally and in this case specifically. It argues that its minimum bill does not have anticompetitive effects and is necessary to prevent NGPL from shifting its cost responsibility to CIG or to CIG's other customers. Finally, CIG claims that even if the minimum bill is anticompetitive, it meets each of the three tests for retaining a minimum bill established in *In re Atlantic Seaboard Corp.*, 38 FPC 91 (1967), *aff'd, Atlantic Seaboard Corp.*

v. Federal Power Comm'n, 404 F.2d 1268 (D.C.Cir. 1968).[4]

CIG made preliminary arguments concerning the minimum bill that will not be discussed in detail here as we find them without merit. Briefly, CIG claims that minimum bills have been found just and reasonable in other proceedings and that CIG's own minimum bill was upheld as reasonable in a prior action. *Colorado Interstate Gas. Co.*, 27 FERC ¶ 61,315 (1984), *aff'd*, 791 F.2d 803 (10th Cir.1986), *cert. denied*, 479 U.S. 1043, 107 S.Ct. 907, 93 L.Ed.2d 857 (1987) (*CIG I*). Thus, it argues, the Commission's action here is inconsistent with FERC precedents.

We are persuaded, however, by FERC's counter-arguments. It makes clear that the action challenged here accords with FERC's "increasingly less tolerant" treatment of minimum bills in recent years. This attitude, largely a result of changes in the gas industry, is reflected in FERC Opinion No. 380 (which eliminated

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[4] Retention of a minimum bill is appropriate, even if it has anti-competitive effects, if it meets any one of three factors (the *Seaboard* factors) that has been identified by the Commission:

> [A] minimum bill may be justified as [1] a means of protecting the pipeline against the risk of not recovering the fixed costs in the commodity component[,] . . . [2] a means of protecting full requirements customers from bearing a disproportionate share of the fixed costs resulting from swings off the system by partial requirements customers[, a]nd [3] . . . as a means of protecting customers from take-or-pay liabilities the pipeline might otherwise incur.

41 FERC ¶ 61,179, at 61,476 (quoting *Seaboard* factors as discussed in FERC opinion in *Transwestern Pipeline Co.*, 32 FERC ¶ 61,009, at 61,031 (1985), *aff'd*, 820 F.2d 733 (5th Cir. 1987)). The D.C. Circuit has interpreted *In re Atlantic Seaboard Corp.* to provide that a minimum bill "may be justified if 'specifically designed to achieve [one of the stated remedial ends], but nothing more.'" *Panhandle Eastern Pipeline Co. v. FERC*, 881 F.2d 1101, 1113 (D.C. Cir. 1989) (quoting *Mississippi River Transmission Corp. v. FERC*, 759 F.2d 945, 950 (D.C. Cir. 1985)).

variable-costs minimum bills) and subsequent rulemaking decisions. *See Texas Eastern Transmission Corp. v. FERC*, 893 F.2d 767 (5th Cir.1990) (citing cases finding minimum bills unjust and unreasonable). Neither Opinion No. 380 nor the Commission's ruling in the prior CIG rate case is inconsistent with FERC's ruling in the instant action. FERC expressly reserved judgment in Opinion No. 380 on the question of fixed-cost minimum bills. In *CIG I* the agency expressed concern about allowing CIG full recovery of its fixed costs; it directed its staff to "consider the proper level of fixed cost recovery" in the next CIG rate case. The "next" case is this case, and FERC's decision here that the proper level of recovery of fixed costs is no recovery (i.e., no minimum bill) thus accords with its earlier rulings.

Moreover, slavish adherence to precedent by an administrative agency would prohibit innovation and adjustment to changing conditions. Obviously, when Congress establishes a regulatory commission the expectation is for the agency to adapt to changing circumstances. This, simply, is what FERC has done here.

Having disposed of CIG's preliminary arguments, we proceed to its two principal assertions: that its minimum bill is not anticompetitive and that, even if it is, it satisfies the traditional criteria for retaining a minimum bill.

FERC acknowledges that it and NGPL carried the initial burden of proof with respect to the minimum bill because CIG had proposed no change in this feature of its rate structure. Although FERC's discussion of its reasons for finding the minimum bill anticompetitive was rather meager, the agency was entitled to rely on the presumption of anticompetitiveness established in *Transcontinental Gas Pipe Line Corp.*, 40 FERC ¶ 61,188, at 61-589-90 (1987) (Opinion No. 260-A). An agency may rely on its general policy as established in an earlier proceeding for the required prima facie showing. *See Kansas Gas & Elec. Co. v. FERC*, 758 F.2d 713, 719-20 (D.C.Cir.

1985) (upholding FERC's order barring the application of a particular rate provision, based on FERC's previously formed conclusion that the provision tends to be unjust and unreasonable, unless the pipeline makes specific showings).[5]

In *Transcontinental Gas Pipe Line Corp.*, FERC decided that "a traditional fixed cost minimum bill usually restrains competition and is presumptively unjust and unreasonable." 40 FERC ¶ 61,188, at 61,590 (1987) (Opinion No. 260-A). Accordingly, FERC established the "policy that in the future a pipeline must carry the burden of producing evidence to justify retention of its fixed cost minimum bill." *Id.* at 61,590. In its brief in this case, FERC also recites the proceedings and cases that have upheld the conclusion that *full*-cost minimum commodity bills are anticompetitive, asserting there is "no reason to assume that the . . . conclusion[s] would have been any different" in those cases had the issue been *fixed* cost minimum bills instead."[6]

In the proceeding below, at least ostensibly, FERC relied not so much on the established presumption as on arguments made by NGPL. NGPL claimed that the minimum bill was anticompetitive because "alternate supply sources must be priced lower than CIG's commodity rate

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[5] *Kansas Gas* cites *NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 290-95, 94 S.Ct. 1757, 1769-72, 40 L.Ed.2d 134 (1974), and *FPC v. Texaco, Inc.*, 377 U.S. 33, 84 S.Ct. 1105, 12 L.Ed.2d 112 (1964), for the familiar principles that "an agency may articulate its general policy in a particular proceeding . . . rather than in a rulemaking," and that an agency "may apply its reasoned analysis of an issue to guide its disposition of individual cases." 758 F.2d at 719.

[6] The D.C. Circuit reached a similar conclusion in *East Tennessee* when it stated that "testimony about the effects of the full-cost minimum bill constitutes substantial evidence supporting the Commission's *prediction* that the fixed-cost minimum bill will also produce anticompetitive results." 863 F.2d at 938 (emphasis in original).

by at least the amount of the minimum commodity bill before the two purchases are equally attractive to [NGPL]." Opinion No. 290, at 61,465 (quoting Exhibit 140 at 10-11). FERC found this "sound theory." *Id.* The agency also considered it significant that CIG admitted it was in a "gas over supply situation." *Id.* FERC held these circumstances sufficient to demonstrate the minimum bill's anticompetitiveness and to shift the burden to CIG. Opinion No. 290, at 61,465 (citing *Transwestern Pipeline Co.*, 36 FERC ¶ 61,175, at 61,589 (1987)).[7] We agree.

CIG's first principal line of argument offered in rebuttal is that minimum bills are just and reasonable generally and in this case specifically. CIG states that, while it remains obligated to stand ready to supply NGPL's full contract entitlement, NGPL has been buying little or no gas from CIG.[8] CIG argues that NGPL's minimum bill does not have anticompetitive effects, pointing to the fact that NGPL has purchased gas from other pipeline companies, at prices higher than the CIG contract price, instead of taking gas under its contract with CIG. CIG concludes this evidence refutes any assertion that NGPL was "forced to forego cheaper gas supplies in order to buy CIG's gas."

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[7] FERC's determination in *Transcontinental Gas* that "a traditional fixed cost minimum bill usually restrains competition and is presumptively unjust and unreasonable," 40 FERC ¶ 61,188, at 61,590 (1987) (Opinion No. 260-A), was based on three factors it considered "common to every case given the current market": First, that gas supplies currently exceed demand; second, that where supplies exceed demand, a "minimum bill by its very nature forecloses competition"; and third, the likely effect of a minimum bill is to "make it 'uneconomic to purchase on a least cost basis.'" *Id.* at 61,589-90 (citation omitted). FERC explicitly or implicitly subscribes to these factors in this case.

[8] CIG asserts that "allowing NGPL to keep its competitor (CIG) obligated to maintain sales service to it" when NGPL intends to purchase no gas is itself anticompetitive and should have been considered by the Commission.

CIG further alleges the minimum bill is necessary to prevent NGPL from shifting NGPL's cost responsibility to CIG or to CIG's other customers.[9] CIG asserts NGPL should not be allowed to avoid paying the fixed cost incurred by CIG as a result of fulfilling its contract obligation to NGPL. This is especially true, CIG claims, because NGPL did not take full advantage of an opportunity in 1984 to reduce its entitlement volume (i.e., renominate) to a level more closely approximating its projected purchases from CIG.

FERC calls "unsubstantiated" the claim that NGPL has been purchasing increasing amounts of gas from other suppliers at higher prices. However, a witness for NGPL testified on cross-examination that during the period May 1985 to September or October 1985 NGPL had purchased 200-250 Bcf of gas at prices exceeding the CIG contract price. This volume was 2.5-3 times NGPL's entitlement from CIG at the time. FERC counters:

> Even if [CIG's] unsubstantiated claim as to [NGPL's] purchasing practices is accurate, it does nothing to answer the obvious fact that absent the minimum bill, [NGPL] might have purchased additional gas supplies from suppliers other than CIG or that it might have sought a different mix of services from its pipeline suppliers.

Pressing this argument, FERC claimed that the price actually paid by NGPL "is not, of course, dispositive of this question," citing for support *Wisconsin Co. v. FERC*, 770 F.2d 1144 (D.C.Cir.1985), *cert. denied*, 476 U.S. 1114, 106 S.Ct. 1968, 90 L.Ed.2d 653 (1986). *Wisconsin Gas* held that the appropriate inquiry in assessing a minimum bill's effect on competition is "not whether a par-

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[9] We note, however, this claim more appropriately fits under CIG's second line of reasoning, which argues that the minimum bill, even if anticompetitive, is necessary. Indeed CIG raises the claim again in its discussion of the second *Seaboard* factor.

ticular pipeline will pursue a least-cost purchasing strategy, but is instead whether the customer will have the *ability* to do so." 770 F.2d at 1159. The *Wisconsin Gas* court noted that, even if some gas customers did not pursue a least-cost strategy, FERC's evidence showed that many would; hence, "elimination of minimum bills can reasonably be expected to lower gas costs and spur competition among pipelines." *Id.*[10]

FERC also finds two flaws in CIG's renomination argument. First, it faults CIG for presuming NGPL was able to predict accurately its future gas purchases from CIG. Second, it asserts that renominating a zero or near-zero entitlement (as CIG suggests NGPL should have done) would have foreclosed NGPL from purchasing gas from CIG, one of its largest historical suppliers. FERC concludes the opportunity to renominate did not "negate the obvious anticompetitive effect" of the minimum bill.

We admit to being somewhat puzzled by NGPL's purchasing practices and sympathetic to the argument that the minimum bill is not discouraging NGPL from purchasing gas from suppliers other than CIG. But testimony by NGPL suggests other factors besides price motivate a gas company's choice of supplier.[11] We will not speculate as to the motives behind NGPL's purchasing decisions. Considering all of CIG's arguments, we do not find substantial evidence to rebut FERC's reasonable

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[10] Since *Wisconsin Gas* the D.C. Circuit also has affirmed FERC decisions to eliminate a company's minimum bill altogether. *E.g.*, *Tennessee Gas Pipeline Co. v. FERC*, 871 F.2d 1099 (D.C. Cir. 1989); *East Tennessee; cf. Trunkline Gas Co. v. FERC*, 880 F.2d 546 (D.C. Cir 1989) In *Trunkline Gas*, it held that "a pipeline with an MFV rate design [does] not require a minimum bill to avoid such disproportion [between full and partial requirements customers]" *Id.* at 550 (citing *East Tennessee*, 863 F.2d at 940).

[11] On cross-examination, an NGPL witness stated: "I don't necessarily agree with you that it is correct to say that \$3.21 [per Mbtu] is higher than \$3.25 [sic] . . . because I think there are other considerations that have to be taken into account."

showing of the anticompetitiveness of minimum bills, including CIG's.

CIG's second principal line of argument is that, even if its minimum bill provision is anticompetitive, it nevertheless merits retention because it meets all of the so-called *Seaboard* factors, the satisfaction of only one of which is sufficient to justify retaining a minimum bill.[12] *Panhandle Eastern Pipeline Co. v. FERC*, 881 F.2d 1101, 1113 (D.C.Cir.1989). FERC rejected CIG's arguments, however, finding the minimum bill satisfied none of the *Seaboard* criteria.

A. *Protecting the pipeline against the risk of nonrecovery of fixed costs.*

Wtih respect to the first *Seaboard* factor, CIG argues that the "minimum bill is necessary to assure that parties [i.e., NGPL] who caused CIG to incur fixed costs bear the costs which they have caused." The minimum bill is needed because NGPL is no longer buying gas from CIG; thus, it is no longer paying those fixed charges included in the sales commodity rate. CIG's brief is somewhat ambiguous on this point, but it appears the costs that CIG claims would be unrecoverable from NGPL without a minimum bill are fixed production and gathering costs, the return on equity and associated income taxes, and carrying charges associated with take-or-pay expenditures allocated to NGPL.

FERC's simple answer to this argument is that the recovery of these costs should not be guaranteed.[13] FERC

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[12] See factors listed in note 4 *supra*.

[13] The Commission also claims that under the modified fixed-variable (MFV) rate design (which FERC, as a result of this rate-making proceeding, ordered CIG to adopt), "a minimum bill to assure recovery of fixed costs is unnecessary." Opinion No. 290, 41 FERC ¶ 61,178 at 61,466. What the Commission apparently means by this is that the demand charge, which NGPL pays under the MFV rate system, contains those fixed costs that FERC has

agrees that the above costs itemized by CIG are not included in the demand charge, but in the commodity charge; accordingly NGPL pays them only when it buys gas. But FERC has decided that these costs should be at risk. *Transcontinental Gas*, 40 FERC ¶ 61,188, at 61,590. This is "sound Commission policy" because it serves as "an incentive to the pipeline to minimize these costs and to make prudent expenditures," and because CIG "should not be guaranteed a profit."

We find D.C. Circuit's reasoning in *East Tennessee* helpful in disposing of this issue. In a similar fact situation the D.C. Circuit held that FERC's policy judgment—that placing at risk certain production costs (such as return on equity) would encourage the pipeline company to increase its competitiveness—was a judgment "well within [FERC's] discretion in deciding what is a just and reasonable rate." 863 F.2d at 939. The court further concluded that this policy judgment constituted substantial evidence for rejecting the first *Seaboard* justification for retaining the minimum bill.[14]

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determined are properly recoverable. The recovery of other fixed costs (e.g., return on equity) should not be guaranteed; thus, a minimum bill is "not necessary."

[14] *Transwestern Pipeline* reached a similar conclusion, and the circuit and FERC in that case explained their reasoning somewhat more thoroughly. The court stated:

> [T]he Commission based its finding on the anti-competitive impact of Transwestern's fixed-cost minimum bills on a prediction of how those minimum bills would operate in the future in markets served by Transwestern.
>
> The Commission based this prediction on evidence in the record, its knowledge of the industry, and common sense. Specifically, the Commission identified three factors. First gas supplies . . . in the [relevant markets] had exceeded demand for the past few years, and the oversupply was likely to continue. Second, the Commission analogized this situation to the treatment of requirements contracts under antitrust law. Where supply exceeds demand, a requirements contract by its very nature forecloses competition. . . . Third, the Commission

In assessing the reasonableness of FERC's judgment that certain costs should be at risk, the *East Tennessee* court noted the pipeline company presented no testimony that it would "not be able to compete for sales effectively" absent a minimum bill. 863 F.2d at 940. It is not clear from the opinion, however, what weight the court would have accorded such evidence had it been offered. Here, CIG makes such an argument in its reply brief. According to CIG, FERC's suggestion that NGPL's minimum bill volume "can readily be 'made up' " by selling gas to other customers is "wholly unrealistic" and "ignores stark market reality." CIG does not cite to evidence in the record that would support this contention, however, and we have found none.[15] CIG also has stated that "its ability to recapture the lost [NGPL] sales is not supported by the record." Opinion No. 290-A, at 61,278. FERC stated in Opinion No. 290-A that it "did not rely on this rationale but merely observed that CIG *might* be

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> observed that a fixed-cost minimum bill would continue to compel a customer to buy gas from Transwestern rather than from a lower-cost competitor.

820 F.2d at 740.

CIG argues *Transwestern* is not applicable here because it is not necessary to *predict* the impact of CIG's minimum bill; it is apparent from NGPL's recent practice of purchasing higher priced gas from other companies that the minimum bill does not have anticompetitive effects.

We have already confessed to being puzzled by NGPL's purchasing practices, but noted testimony by NGPL suggesting other factors besides price motivate a gas company's choice of supplier. *See supra* text at 1462. We will not speculate as to the reasons for NGPL's purchasing decisions or the likelihood of its future purchasing patterns. We can safely assume, however, that FERC's "common sense" and "knowledge of the industry," 820 F.2d at 740, do not vary from case to case with respect to the same ratemaking issue. These are persuasive factors here as they were in *Transwestern*.

[15] FERC claims that none of the factual assumptions underlying CIG's claim that it would not be able to compete effectively for other gas sales is supported by record evidence.

able to compete for more business." Opinion No. 290-A, at 61,278 (emphasis added).

We do not find CIG's argument on this point persuasive, nor will we set aside FERC's judgment on the basis of factual arguments apparently raised for the first time in this appeal. We find no basis on which to disagree with FERC's balancing of the relevant interests and its ultimate conclusion that certain fixed costs should not be recovered, through a minimum bill or otherwise. It is apparent that FERC is spurring CIG to become more competitive in its marketing of natural gas rather than sit back, do nothing and still be assured of recovering costs and achieving profits. Thus, we hold the Commission's rejection of the first *Seaboard* factor was neither arbitrary nor capricious.

B. *Protecting full requirements customers.*

Similarly, we find reasonable FERC's arguments for rejecting the second *Seaboard* justification—that the minimum bill is necessary to protect CIG's full-requirements customers from bearing a disproportionate share of fixed costs.[16] FERC did not deny that CIG itself or some of its other customers might bear the burden of paying fixed costs not paid by NGPL. It concluded, however, that "the benefits to ratepayers of placing [CIG] at risk for [certain] costs here involved outweigh the potential detriment of shifting those costs to full requirements customers." 41 FERC at 61,466 (citing *Transcontinental Gas*, 40 FERC ¶ 61,188, at 61,590.) CIG claims FERC's reasoning "completely dismisses this second criterion."

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[16] FERC noted that, in CIG's rehearing request, "CIG did not specifically claim . . . that its minimum bill is needed to protect full requirements customers from bearing a disproportionate share of the fixed costs." Opinion No. 290-A, 43 FERC ¶ 61,089, at 61,278 n.33. CIG has raised the issue here, however.

In its brief FERC offers the following explanation for its conclusion regarding *Seaboard* factor 2. The "benefits to ratepayers" to which its opinion refers, FERC asserts, "are well known to CIG and other members of the natural gas community that participated in the Commission's Order No. 380 rulemaking proceeding [eliminating recovery of variable costs from minimum bills]." FERC cites, without listing, "several benefits" identified by the D.C. Circuit in reviewing that order (citing *Wisconsin Gas*, 770 F.2d at 1161). The "most significant" of these benefits is "lower prices for all customers resulting from the increased incentive to compete vigorously in an environment where minimum bills do not maintain gas prices at artificially high levels." [17] As for the "costs" of eliminating the minimum bill, FERC also adopted the *Wisconsin Gas* court's finding that the harm, if any, to full requirements customers "would be isolated, of short duration, and ontweighed by the overall long-term benefits to these customers."

FERC's brief makes clear what its challenged orders do not—that FERC views the costs and benefits of eliminating the minimum bill "from a 'national perspective' " (quoting 770 F.2d at 1161). This was also the view FERC adopted in its rulemaking eliminating recovery of variable costs in all minimum bills, an approach affirmed by the D.C. Circuit in *Wisconsin Gas.* Since then the D.C. Circuit has affirmed FERC's reliance on this balancing test in eliminating a company's minimum bill altogether. *East Tennessee*, 863 F.2d at 940. *See In re Atlantic Seaboard Corp.*, 404 F.2d at 1274 ("task of determining what interests should be protected, and to what extent,

[17] FERC states in its brief that "the Commission identified an additional benefit—the increased ability of CIG to compete for transportation service in an effort to recoup lost sales revenue" (citing 41 FERC at 61,466). It is not clear to us, however, whether FERC construed this as a "benefit" of eliminating the minimum bill, or merely an additional mechanism CIG could employ in attempting to offset its lost income.

is a policy matter for the agency"). We also find it a reasonable approach.

In order to overcome the foregoing considerations, FERC requires a pipeline to "produce evidence to show that excessive cost-shifting would occur on its system in the absence of a minimum bill." *Tennessee Gas*, 871 F.2d at 1105. FERC and the D.C. Circuit interpret this requirement to mean "concrete evidence" not simply speculation. *Id.* Here FERC stated CIG "must offer more than broad generalities and vague possibilities of economic calamities" that might result in the absence of a minimum bill, and that "CIG must *specifically* demonstrate that *particular* full requirements customers are likely to bear higher overall rates as a result of the minimum bill's elimination" (citing *Mississippi River Transmission Corp. v. FERC*, 759 F.2d 945, 955 (D.C.Cir.1985)).

This approach to the second *Seaboard* justification, approved by the D.C. Circuit, has been described in more detail by FERC in at least two prior cases. In *Tennessee Gas Pipeline Co.* and *Transwestern Pipeline Co.*, FERC made clear it will not

> approve a minimum bill simply because there exists the slightest possibility that some costs will be shifted to full requirements customers. . . . To balance these conflicting interests the initial questions that must be answered are: Will the full requirements customers be affected . . . ? If so, by how much? These questions are intensely factual. They turn on the resolution of such subsidiary questions as: Will the partial requirements customer in fact reduce its purchases? If so, by how much? Will the reduction be short-term or long-term? Will the pipeline reduce its costs to compete for the partial requirements customer? And, will the pipeline increase sales to other customers be they existing or new?

Tennessee Gas, 871 F.2d at 1105 (quoting 40 FERC ¶ 61,140, at 61,437), and (36 FERC ¶ 61,175, at 61,145).

FERC concluded here and we agree that "CIG simply has not demonstrated any shifting of costs with sufficient specificity to warrant the retention of its minimum bill." Thus, FERC reasonably rejected the second *Seaboard* justification.[18]

C. *Protecting customers from take-or-pay liabilities.*

Finally, FERC concluded the minimum bill does not serve as a means of minimizing take-or-pay costs—the third *Seaboard* justification.[19] Here, too, FERC held CIG's evidence insufficient to make the required showing. It found that "CIG . . . has shown no specific connection between its minimum bill and its take-or-pay obligations." Opinion No. 290, 41 FERC at 61,466. Specifically, FERC noted that "CIG has not referred to any record evidence that [NGPL's] cutbacks caused or will cause particular minimum bill or take-or-pay obligations to be incurred [by CIG]." Opinion No. 290-A, 43 FERC at 61,278.[20]

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[18] The petitioner in *Tennessee Gas Pipeline Co.*, in arguing that its minimum bills satisfied the second *Seaboard* test, claimed that its partial requirements customers had reduced their purchases to substantially less than their entitlements. The D.C. Circuit rejected this evidence as "not probative under the second justification since it relates to drops in volume experienced while Tennessee had a minimum bill in place; it therefore indicates nothing about how elimination of the bill would itself cause a drop." 871 F.2d at 1105 n.8. We reject CIG's attempt to use evidence concerning NGPL's reduced purchases in the same way here.

[19] FERC explains that most interstate pipelines enter into contracts with producers whereby they agree to pay for a minimum volume of gas, even if not actually taken. If a pipeline's own sales decrease, it can "find itself unable to take enough gas from its supplier to meet its contractual take-or-pay obligations."

[20] FERC notes in footnote 35 of Opinion No. 290-A that CIG's minimum bill is not designed solely to remedy its take-or-pay problem, as required to satisfy the third *Seaboard* test. The D.C. Circuit has interpreted *In re Atlantic Seaboard Corp.* to provide that a minimum bill "may be justified if 'specifically designed to achieve

Requiring a specific connection is consistent with FERC's approach affirmed in other cases. For example, *Tennessee Gas* held that a minimum bill can be justified under this factor "if it links cost-incurrence with cost-causation, *i.e.*, if it assists in collecting take-or-pay costs from those customers that have caused the costs by reducing their purchases." 871 F.2d at 1105.[21] While CIG alleged such a connection, it offered no evidence in support thereof. Indeed, it may have been unable to make such a demonstration, given that CIG's sales to customers other than NGPL apparently also had declined in recent years.

CIG calls FERC's assertions on this issue "cavalier" and "disingenuous in light of the facts." Yet the "facts"

[one of the stated remedial ends], but nothing more.'" *Panhandle Eastern Pipeline Co. v. FERC,* 881 F.2d 1101, 1113 (D.C. Cir. 1989) (quoting *Mississippi River Transmission Corp. v. FERC,* 759 F.2d 945, 950 (D.C. Cir. 1985)).

[21] The D.C. Circuit in *Tennessee Gas* recognized the pipeline company's "not . . . insubstantial" concern about the general need for a minimum bill in its rate structure in light of its own take-or-pay liabilities, and noted FERC's "'insouciance on take-or-pay.'" 871 F.2d at 1106 (quoting 824 F.2d at 1044). The court admitted to being "concern[ed] about FERC's unwillingness to meet the take-or-pay challenge head-on . . .," but was "relieved by [FERC's] actions [relevant to take-or-pay] in other proceedings." *Id.* Interestingly, the court concluded that as a result of those proceedings, particularly FERC's Order No. 500, 52 Fed. Reg. 30,334 (1987), the third *Seaboard* factor probably "will retain little vitality in the future." 871 F.2d at 1106. The Fifth Circuit recently has gone even farther, calling minimum bills "unsalvageable by the *In re Atlantic Seaboard* factors when the MFV design is used." *Texas Eastern Transmission Corp. v. FERC,* 893 F.2d 767 (5th Cir. 1990).

FERC's interim rule in Order No. 500 was vacated and remanded by *American Gas Ass'n v. FERC,* 888 F.2d 136 (D.C. Cir. 1989). Pursuant to the court's judgment, FERC promulgated a final rule on Dec. 21, 1989. 54 Fed. Reg. 52,344. The final rule continued the take-or-pay crediting regulations adopted in Order No. 500, with two modifications. *Id.* Several producers and pipeline operators filed petitions for review of the Commission's revised order, and the D.C. Circuit again vacated and remanded in *Associated Gas Distributors v. FERC,* 893 F.2d 349 (D.C. Cir. 1989).

relied on by CIG are remarkably skimpy. For example, CIG claims it purchases gas under firm take-or-pay contracts in order to meet NGPL's demand. But CIG's only citation to the record in support of this claim is incomplete and misleading. Testimony immediately following the statement to which CIG refers states that CIG does not necessarily incur take-or-pay liability "to the extent it is unable to sell gas to [NGPL]." And CIG cites no facts to bolster its argument that the CIG minimum bill, "[b]y providing an economic incentive to NGPL to buy from CIG, . . . allows [CIG] to *avoid* take-or-pay deficiencies." (Emphasis in original). Indeed, CIG disregards the glaring inconsistency between this allegation and its repeated emphasis on NGPL's failure to buy CIG's gas in favor of more costly supplies.

The Commission also points out that CIG has not quantified any take-or-pay costs it has incurred allegedly because of NGPL's failure to buy gas. FERC further argues that elimination of a minimum bill "does not invariably lead to increased pipeline take-or-pay costs," noting that CIG's minimum bill contains a crediting provision like the one in *Wisconsin Gas*, which allowed penalty payments to be credited to subsequent gas purchases. *See* 770 F.2d at 1160. CIG has responded to neither of these arguments.

Accordingly, the Commission determined, and we agree that CIG has not adequately demonstrated its minimum bill was necessary to enable CIG to collect its take-or-pay costs. Allegations and arguments claiming necessity to protect customers from take-or-pay liabilities are not sufficient. Having failed to satisfy any of the three *Seaboard* justifications for retaining a minimum bill, FERC properly concluded the bill was unjust and unreasonable and should be eliminated.

II. Transportation Rates

The second issue on appeal is FERC's rejection of CIG's requested transportation rate change. CIG proposed to increase its on-system ("EUS-1"), or sales displacement, rate from 36¢ to approximately 60.95¢ per million cubic feet (Mcf). It also proposed an off-system ("EUS-2") rate of 30.63¢ per Mcf. CIG argues FERC erred in rejecting its proposal and in establishing the same rate for on- and off-system transportation,[22] but that even if FERC's rate design is upheld, it should not be applied to certain certificated transactions.

CIG argues the increased on-system rate is needed to pay the costs it fails to recover when it merely transports gas to its on-system market, versus when it makes a gas sale. Transporting gas on-system displaces its own sales, CIG asserts; thus the pipeline suffers an "economic penalty" if the transportation rate does not recover the same costs that a sale would recover. CIG's proposed on-system rate was designed to "recover [CIG's] fully allocated sales commodity rate." According to CIG, off-system transportation incurs lower costs and it "represents new, incremental business that will absorb a share of system-wide costs and benefit all other customers."[23]

CIG claims the evidence submitted by CIG and the Commission staff "fully supported the very obvious class of service *and* cost distinction between 'off-system' transportation business which is truly 'incremental,' and transportation to on-system markets historically served by CIG (*i.e.*, 'sales displacement' transportation)." Further-

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[22] There is some confusion as to what FERC actually did—set one rate applicable to both types of service, or simply reject the proposed increase for on-system service. We conclude it did the latter. See our discussion in the text *infra*.

[23] FERC points out that much of CIG's presentation in favor of the rate increase is made "belatedly"—in its brief on appeal, rather than before the ALJ.

more, it claims "[t]here was no evidence submitted in opposition to this rate design." CIG bears the burden of proving the reasonableness of its proposed rate increase. But CIG has directed us to no evidence that "fully supports" the rate differential, and we have discovered none.[24]

The ALJ concluded that on- and off-system service "appear[] to be comparable." According to FERC and CIG, the ALJ consequently required that the rate charged for on-system service equal that charged for off-system transportation, thus lowering the on-system rate from 36¢ to 31¢. However, we can find no indication in the ALJ's decision nor in FERC Opinion No. 290 or 290-A that FERC affirmatively lowered the rate for on-system transportation below its level prior to CIG's proposed rate increase (i.e., 36¢). Moreover, arguments presented by intervenor Big Horn Fractionation Co. (Big Horn), upon which the ALJ relied heavily, urged only that the on-system rate be returned to the prior 36¢ level.[25]

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[24] Counsel for an intervenor in the FERC proceeding asked a witness for the FERC staff where in the record "anyone interested in trying to understand the rate increase" would look. The FERC staffer admitted it was "a valid question," but stated "it's a little bit difficult," and ultimately could point to no record evidence. He suggested that explanations relevant to the rate increase were in a portion of CIG's filings that FERC had rejected.

[25] Later, however, Big Horn's successor, Western Gas Processors, Ltd., stated that the ALJ and the Commission "concluded that under the non-discrimination requirement of Section 4 of the [Natural Gas Act], the two rates had to be equal." According to Western Gas, FERC thus ordered CIG to charge 31¢ for all transportation service. As discussed in the text, we do not reach the same conclusions.

We also note that this case involved other transportation rate issues that were not appealed to this court. In one instance the ALJ approved the inclusion of storage costs in a transportation rate; in another, he disallowed such costs. This would seem to refute Western's assertion that the "non-discrimination" provision "requires" that rates be equal.

The ALJ devoted one-and-a-half pages of an eighty-page opinion to the transportation rate issue. 35 FERC ¶ 63,043, at 6767-68. FERC summarily affirmed the ALJ's decision in Opinion No. 290, 41 FERC at 61,454; upon CIG's request for rehearing, it allotted one page of discussion to the issue in Opinion No. 290-A, 43 FERC at 61,272-73. CIG faults FERC for affirming the ALJ's decision on this issue "without discussion of the true cost incurrence and cost responsibility difference." The pipeline concludes the ALJ and FERC orders are "completely unsupported and arbitrary and capricious."

In the hearing before the ALJ, CIG and the FERC staff apparently agreed that the on-system transportation rate should "equal the non-gas component of the sales rate . . . in order to allow CIG to be economically indifferent as to whether it sells or transports gas." Thus, the FERC staff initially favored CIG's proposed rate increase; however, it subsequently reversed its position and now supports the ALJ's decision.

The ALJ concluded that the proposed rate "has not been shown to be just and reasonable particularly, in light of the continuation of the much lower rate for what appears to be comparable service under [the off-system rate]." The ALJ relied heavily on arguments made by Big Horn (predecessor of Western Gas Processors, Ltd.), an intervenor in the rate proceeding. Big Horn argued that CIG had not adequately justified the requested rate change and that it should be required to refile a rate that would recover only CIG's transmission costs. The ALJ found Big Horn's position had merit and rejected the proposed increase.

As the proponent of the rate change, CIG bears the burden of demonstrating that it is just and reasonable. But CIG's arguments are based largely on conjecture and appear flawed as a matter of logic. As Big Horn argued to the ALJ, "[i]t seems incredible . . . that

[CIG] would burden interruptible . . . service [customers] with the fixed costs for production, gathering, and storage as per the . . . sales rate (for firm service)." And FERC points out that CIG makes inconsistent arguments with respect to transportation rates. In a portion of its rate case not appealed here, it urged that storage costs should not be included in transportation rates, yet it makes the opposite argument here.

In contrast to CIG's presentation on this issue, Big Horn offered extensive arguments opposing the change. The ALJ was persuaded by those arguments, and FERC concurred. We must agree that CIG has not borne its burden of persuasion on this issue.

We hold only that CIG has not demonstrated that its proposed 60.95¢ rate for on-system transportation is reasonable; thus, we affirm FERC's rejection of the rate increase. Despite FERC's and CIG's contrary interpretations in their briefs, we do not read the ALJ's decision or either of FERC's orders as establishing an on-system transportation rate of 30.63¢, the rate CIG proposed for off-system service. The ALJ found only that the two classes of service were "comparable," not that they were "equal." [26] No party to the FERC proceeding argued that the rates for the two types of service should be equal, nor did any party object to CIG's proposed off-system rate. In the absence of any evidentiary basis for reducing the on-system rate below the prior systemwide level of 36¢, we construe FERC's orders as rejecting the on-system rate increase, restoring the 36¢ systemwide transportation rate, and ordering appropriate refunds.[27]

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[26] The ALJ stated simply that the "increase in the EUS-1 rate from 36 cents to 60.95 cents . . . has not been shown to be just and reasonable particularly, in light of the continuation of the much lower rate for what appears to be comparable service under EUS-2."

[27] CIG's EUS-1 and EUS-2 rates went into effect subject to refund (i.e., subject to FERC's eventual determination as to the rates' reasonableness) on September 28, 1985. Accordingly, pursuant to

If FERC wishes to reduce this rate to the EUS-2 level (30.95¢), it may do so only according to the procedures specified in 15 U.S.C. § 717d and regulations promulgated thereunder.

Lastly, CIG claims that, even if FERC's rate design is upheld, it should not be applied to certain transactions for which FERC has issued certificates of "public convenience and necessity." 15 U.S.C. § 717f. FERC terms this "an impermissible collateral challenge to Commission-issued certificates that never were appealed and now are final." The certificates, each of which included a "fully compensatory, cost recouping, sales displacement rate, such as the EUS-1 Rate (*i.e.*, 61¢/Mcf)," were issued "subject to the outcome" of this rate proceeding. CIG states that the specific transactions covered by these certificates "*were not even subject to Rate Schedule EUS-1*, and that the rate provided in that rate schedule was merely *referenced* by CIG and the Commission as a 'shorthand' for a fully compensatory, sales displacement, transportation rate."

FERC argues that the "subject to the outcome" condition, which was included in each of the certificates, requires that the on-system rate ultimately found to be just and reasonable in this case becomes the rate applicable to each certificate. Upon CIG's request for rehearing of FERC's EUS-1 decision, FERC held that this rate proceeding "is not the appropriate forum to discuss the effects of the conclusions with respect to the EUS-1 rate on other issues [i.e., the certificates] in other dockets." Opinion No. 290-A, 43 FERC ¶ 61,089, at 61,273 n.7. In responding to the issue now raised by CIG, FERC declares: "This Court's analysis therefore comes

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our disposition of this appeal, CIG must make refunds based on the on-system transportation rate of 36¢ for the period during which the 60.95¢ rate was in effect. *See* FERC Opinion No. 290-A, 43 FERC at 61,273.

to an end once it affirms the decision of the Commission to lower CIG's EUS-1 on-system transportation rate."

Neither party has provided us with copies of these certificates; thus we are unable to review the precise language of the disputed condition. Moreover, CIG did not even identify to FERC the specific certificates that warranted rehearing. Opinion No. 290-A, 43 FERC ¶ 61,089, at 61,273 n.7. Although it appears that CIG has now identified those certificates, we will not review them or the related proceedings de novo. Therefore, we cannot say that FERC's determination that "CIG should raise those issues in the relevant certificate proceedings" is unreasonable.

AFFIRMED.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

No. 88-1932

COLORADO INTERSTATE GAS COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent,

THE GATES RUBBER COMPANY; QUESTAR PIPELINE COMPANY; K N ENERGY, INC.; CITY OF COLORADO SPRINGS; NATURAL GAS PIPELINE COMPANY OF AMERICA,
Intervenors.

ORDER

Filed August 23, 1990

Before HOLLOWAY, Chief Judge, McKAY, LOGAN, SEYMOUR, MOORE, ANDERSON, TACHA, BALDOCK, BRORBY, EBEL, Circuit Judges and BRATTON *, District Judge.

This matter comes on for consideration of petitioner's petition for rehearing and suggestion for rehearing en banc in the captioned cause.

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* The Honorable Howard C. Bratton, Senior Judge, United States District Court for the District of New Mexico, sitting by designation.

Upon consideration whereof, the petition for rehearing is denied by the panel that rendered the decision sought to be reheard.

In accordance with Rule 35(b) of the Federal Rules of Appellate Procedure the suggestion for rehearing en banc was transmitted to all the judges of the court in regular active service. No member of the panel and no judge in regular active service on the court having requested that the court be polled on rehearing en banc, Rule 35, Federal Rules of Appellate Procedure, the suggestion for rehearing en banc is denied.

Entered for the Court

/s/ Robert L. Hoecker
ROBERT L. HOECKER
Clerk

APPENDIX C

FEDERAL ENERGY REGULATORY COMMISSION

Docket No. RP85-122-000

COLORADO INTERSTATE GAS COMPANY

Opinion No. 290; Opinion and Order Affirming in Part, and Reversing in Part, Initial Decision

(Issued November 18, 1987)

Before Commissioners: Martha O. Hesse, Chairman; Anthony G. Sousa, Charles G. Stalon, Charles A. Trabandt and C. M. Naeve.

[Note: Initial Decision of the presiding administrative law judge upon rate filing issued May 13, 1986, appears at 35 FERC ¶ 63,043.]

[Opinion No. 290 Text]

Introduction

On March 28, 1985, Colorado Interstate Gas Company (CIG) filed for a general rate increase under section 4(e) of the Natural Gas Act. On April 26, 1985, the Commission accepted CIG's tariff sheets for filing, suspended them for five months to become effective September 28, 1985, subject to refund, and set the matter for hearing.[1] On May 13, 1986, the Administrative Law Judge (ALJ) issued his initial decision in which he resolved numerous issues.[2] The Commission's staff, CIG, the Colorado Attorney General (CAG), the Public Service Company of Colorado, Western Gas Supply, and

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[1] *Colorado Interstate Gas Co.*, 31 FERC ¶ 61,096 (1985).

[2] *Colorado Interstate Gas Co.*, 35 FERC ¶ 63,043 (1986).

Cheyenne Light, Fuel and Power Company (PSC), Greeley Gas Company, and the City of Colorado Springs, Colorado (Colorado Springs) filed briefs on exceptions to the initial decision. The Commission staff, CAG, CIG, PSC, Mountain Fuel Resources, Inc. (Mountain Fuel), Southwest Gas Corporation (Southwest), Natural Gas Pipeline Company of America (Natural), KN Energy, Inc. and Western Gas Processors, Ltd. (Western Gas) filed briefs opposing exceptions.[3] As discussed below, the Commission affirms the initial decision in part and reverses the initial decision in part. The Commission summarily affirms the initial decision with respect to the following issues:

1. Employee Benefits and Pensions

2. Windfall Profits Tax

3. Unfunded Tax Liability (South Georgia Add Back)

4. Regulatory Commission Expense

5. Account Nos. 759 and 858

6. Account No. 490

7. Depreciation

8. Fuel Use, Lost and Unaccounted for Gas, Air Injection, and Transportation and Exchange Imbalance

9. Cost Allocation and Rate Design—United v. Seaboard v. Modified Fixed-Variable (MFV)

10. Rate Schedule PR-1

11. Demand Charge Credit to H-1 Rate

12. Systemwide Gathering

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[3] The CAG's motion to strike certain portions of CIG's Brief on Exceptions is denied.

13. Transportation Rates—Account No. 858

14. Design of EUS-1 Transportation Rate

I. Cost of Service

A. O & M Expense

The ALJ concluded that no issue remained with respect to the $489,203 in increased operation and maintenance (O&M) expenses for various facilities.[4] PSC excepts, contending that the ALJ was misled by CIG's representation in its reply brief that these O&M expenses had been removed in compliance filings in this proceeding on September 6, 1985 and September 30, 1985. According to PSC, the September 6 filing merely eliminates costs associated with facilities projected not to be placed in service by September 30, 1985, and the September 30 filing merely incorporates the September 6 revisions on this issue.[5] On this basis, PSC continues to press its claim that CIG failed to describe with sufficient specificity the facilities for which the O&M expenses had been claimed.[6]

As proponent of a rate increase, CIG bears the burden of persuasion.[7] In Statement H(1)a of its initial filing (which was sponsored, unchanged, by CIG witness Greenwood as part of Exhibit 25), CIG proposed $489,203 in increased "operation and maintenance expense for [certain] facilities." Although Greenwood claimed in his supporting testimony[8] that one of the primary reasons for this increase was anticipated O&M expenses at the Morton County Chiller Plant, this plant is nowhere specifically identified in Statement H(1)a. Because of the lack of

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[4] 35 FERC at p. 65,133.

[5] PSC Brief on Exceptions, pp. 4-5.

[6] *Id.* at 3-5.

[7] *Public Service Commission*, 642 F.2d at 1345.

[8] Exhibit 22, p. 7.

specificity, PSC witness Stinson proposed in the direct testimony that CIG's adjustment be disallowed. He also opposed the adjustment because there was no indication that similar facilities might not be removed from service during the test year, thus decreasing O&M expenses.[9]

While Greenwood submitted extensive rebuttal testimony to other adjustments proposed by Stinson and adjustments proposed by staff witnesses,[10] he neither rebutted Stinson's testimony nor supported the proposed increase in O&M expense by describing specific facility additions.

There has been no showing in this record that the claimed O&M expenses pertain to facilities which have been placed in service. CIG has not come forward with evidence to support its proposed rate increase. Accordingly, it shall be disallowed.

B. Overhead Charges

In the initial decision the ALJ made a $1,877,447 downward adjustment to CIG's filed test period overhead payment to the Coastal Corporation (Coastal), its parent. CIG had filed to include $4,177,970 in such payments. The ALJ stated that CIG and staff had agreed to the $1,877,447 reduction, and that only PSC had opposed it, urging an additional reduction of approximately $500,000.[11] PSC excepts to the initial decision on this issue, and CIG opposes the exception.[12]

PSC argues that the ALJ erred in stating that CIG and staff agreed on this issue, since CIG indicated its

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[9] Exhibit 10, pp. 4-5.

[10] *See* Exhibits 26-30.

[11] 35 FERC at p. 65,133; *See* PSC Brief on Exceptions, p. 5.

[12] PSC Brief On Exceptions, pp. 5-8.

concession for the first time in its reply brief.[13] The Commission finds no error in the ALJ's finding.

PSC also argues that the ALJ erred in concluding that PSC's position was unsupported.[14] PSC claims that its witness (Stinson) presented the only rationale for any adjustment to overhead expenses.[15] Through data requests, PSC discovered that CIG, under the Massachusetts formula,[16] was required to pay 23.99 percent of Coastal's overhead expenses. In 1985, Coastal acquired American Natural Resources Company (ANR). Since the base period in this proceeding was calendar year 1984, CIG's initial filing did not reflect this acquisition. Incorporating ANR's 1984 plant, revenue, and payroll information into the Massachusetts formula, Stinson calculated CIG's share of overhead expenses as $1,769,411, a reduction of $2,408,559 to CIG's filed amount.[17] No party rebutted PSC's evidence.

Staff's entire evidentiary presentation on this issue consisted of the following:

> Corporate overhead costs charged by Coastal States Management Corporation to CIG and booked to Account 923-Outside Services Employed, were reduced by $1,877,447 to reflect Coastal's recent acquisition of ANR Pipeline Company.[18]

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[13] *Id.* at 7.

[14] *Id.*

[15] *Id.; See* Exhibit 10, pp. 7-8; Exhibit 11, pp. 2-7.

[16] Under the Massachusetts formula, a parent company's overhead expenses are paid by the subsidiaries on the basis of three equally weighted factors: labor costs, gross plant, and gross revenues. *See Midwestern Gas Transmission Co.*, 32 FPC 1012, 1022-25, *affd in pertinent part*, 32 FPC 993, 995 (1964).

[17] PSC Brief on Exceptions, p. 6.

[18] Exhibit 164, pp. 4-5.

Although no party rebutted staff's evidence, PSC was the only party which credibly analyzed the impact of the ANR acquisition. Its witness compared pre-[19] and post-[20] acquisition overhead expenses, using the formula which is used by CIG and Coastal. Staff's evidence consists of a bore allegation that the proposed reduction reflects the ANR acquisition.

The Commission finds that the ALJ erred in concluding that PSC's position was unsupported. To the contrary, PSC's analysis is more thorough than staff's. Accordingly, the initial decision shall be reversed on this issue, and PSC's position shall be adopted.

C. Rate of Return

The ALJ adopted a rate of return on equity of 13.32 percent. For the most part, he adopted staff's position, finding its Discounted Cash Flow (DCF) analysis to be superior to CIG's "opportunity cost" or "comparable earnings" methodolgy, and to the DCF studies sponsored by CAG and Colorado Springs. The ALJ did not, however, acknowledge the validity of staff's contention that CIG's jurisdictional business is less risky than its non-jurisdictional business. Accordingly, he rejected staff's downward adjustment to a 12.63 percent rate of return on equity.[21]

Staff excepts to the ALJ's refusal to apply its downward adjustment, and opposes the exceptions of CIG.[22] CIG excepts to the ALJ's rejection of its suggested 15 percent rate of return on equity, arguing that a 13.32 percent rate of return on equity is inadequate in light of

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[19] Exhibit 11, p. 2.

[20] *Id.* at 3.

[21] *See* 35 FERC at pp. 69,136-40.

[22] Staff Brief on Exceptions, pp. 18-21; Staff Brief Opposing Exceptions, pp. 20-23.

the risks it faces. CIG also opposes staff's exception on the downward adjustment.[23] CAG filed briefs on and opposing exceptions, arguing that the ALJ erred in failing to take account of CIG's relatively low financial risk, and contending that CIG did not support a 15 percent rate of return on equity.[24]

The initial decision is affirmed with respect to its adoption of staff's DCF study of comparable companies.[25] Contrary to the initial decision, staff's adjustment shall be made to reflect the lower risk of CIG's jurisdictional operations relative to its total operations. Commission precedent supports such adjustments.[26] Staff presented evidence that CIG's jurisdictional volumes and revenues grew more rapidly than its total volumes and revenues from 1976 through 1985.[27] Since this evidence indicates relatively low jurisdictional risk, the adjustment proposed by staff shall be adopted as just and reasonable. Accordingly, CIG's rate of return on equity shall be set at 12.65 percent.

II. Cost Allocation and Rate Design

A. Rate Schedule EX-1

Rate Schedule EX-1 is an interruptible overrun rate, available to Rate Schedule G-1 and Rate Schedule P-1 customers and designed, respectively, at the commodity

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[23] CIG Brief on Exceptions, pp. 57-63; CIG Brief Opposing Exceptions, pp. 32-34.

[24] CAG Brief on Exceptions, pp. 7-10; CAG Brief Opposing Exceptions, pp. 4-5.

[25] *See* 35 FERC at p. 65,139.

[26] *See Arkansas Louisiana Gas Co., a Division of Arkla, Inc.*, 31 FERC ¶ 61,318, at p. 61,730 (1985); *Tennessee Gas Pipeline Co.*, 25 FERC ¶ 61,020 (1983); *Consolidated Gas Supply Corp.*, 24 FERC ¶ 61,046 (1983); *Ozark Gas Transmission System*, 16 FERC ¶ 61,099 (1981).

[27] Exhibit 181, pp. 27-30.

component cost of the G-1 and P-1 rates schedules. As a pure commodity rate, the EX-1 failed to include any demand-rated costs.[28] Staff and CAG sought the allocation of demand related costs to EX-1 based on their argument that EX-1 sales are being made during peak periods. The ALJ summarized staff's position as requiring that all customers using the pipeline system during peak periods of utilization should pay demand-related costs in their rates. Staff argued that the subsidization of such peaking service by only part of a customer group has distorted the market and must be corrected.[29]

CIG contended that since it had not proposed a change, the burden was on staff to show that its existing practice was unjust and unreasonable. Further, CIG asserted that, since the EX-1 service is interruptible, customers receiving such service cannot rely on it during peak periods and that its sales would be reduced if an assignment of demand costs were made to this service.[30]

The ALJ stated that neither staff nor CAG had met its burden to show that CIG's cost allocation to EX-1 exclusive of demand related costs, is unjust or unreasonable.[31] Staff filed a brief on exceptions and PSC, CIG and Mountain Fuel filed briefs opposing exceptions. For the reasons given below, the Commission will reverse the ALJ's finding and include demand related costs in CIG's EX-1 rate schedule.

Staff contends that not only was service rendered under the EX-1 rate schedule during the three-day peak, but service was at levels four times greater than the average daily deliveries under this rate schedule.[32] Staff argues

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[28] 35 FERC at p. 65,148 (1986), *citing* Exhibit 172.

[29] *Id.* at 65,149 (1986).

[30] *Id.*

[31] *Id.*

[32] Staff Brief on Exceptions, p. 8 *citing* Exhibit 172 at 35.

that CIG's design of EX-1 disregards this peak day utilization and that continuation of this rate design will allow EX-1 customers to receive subsidized service. Staff asserts that *all* customers using the pipeline system during peak periods should pay their fair share of such costs, including demand costs.[33]

Mountain Fuel asserts that contrary to staff's suggestion, the EX-1 rate does contain fixed, i.e., demand-related costs. Mountain Fuel maintains that under staff's proposed MFV rate design, fixed costs assigned to the commodity charge, which are incorporated in the EX-1 rate, include CIG's return on equity and associated taxes, which are associated with all of CIG's facilities including those which have only peak day functions, and all fixed production and gathering costs.[34]

Further, Mountain Fuel asserts that since customers may purchase EX-1 gas only when it is available, and since these customers do not have the right to demand such gas or to impose any requirements on CIG, sales demand charges should not be built into this rate.[35]

Mountain Fuel also contends that CIG has experienced and will continue to have difficulty marketing its gas even when such gas is being sold at EX-1 rates equal to its G-1 and P-1 commodity rates.[36] Mountain Fuel argues that acceptance of staff's proposal can only compound CIG's marketing, throughput and take-or-pay problems to everyone's detriment.

PSC states that customers cannot rely on EX-1 gas on any given day and EX-1 gas is available to Rate Schedules G-1 and P-1 customers only after they have taken

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[33] Staff Brief on Exceptions, p. 8 *citing* Exhibit 172 at 36; Tr. at (1732-36).

[34] Mountain Fuel Brief Opposing Exceptions, p. 15.

[35] *Id.*

[36] *Id.* at 17 *citing* Tr. at 1724-26, 1736-37

their full contractual entitlement under those rate schedules. PSC states that because Rates Schedules G-1 and P-1 customers must take their full contractual entitlement of G-1 or P-1 gas for which demand charges are paid before taking EX-1 gas, staff's concern about a "free ride" is unfounded.[37] PSC also claims that staff's "free ride" concern is mitigated by the fact that the record shows no evidence that any of CIG's Rate Schedule G-1 or P-1 customers have reduced their nominations under those rate schedules in reliance on the availability of Rate Schedule EX-1 gas.[38]

CIG claims that it designed the EX-1 rate schedule by use of the same cost allocation principles that have been previously used by the Commission and CIG for this purpose.[39] CIG notes staff's assertion that sales by CIG under this rate schedule should bear demand costs, as some of the sales are made during peak periods, but CIG contends that customers cannot rely on this service which is interruptible. Further, CIG contends that the assignment of demand-related costs to the EX-1 rate schedule would reduce its sales.[40]

The Commission agrees with staff's assertion that the purpose of allocating demand-related costs (the D-1 demand charge under MFV) is to assign those costs to customers using pipeline capacity during peak deliveries. Staff's witness states that during CIG's actual average three-day peak in 1983-4 and 1984-5, service was rendered to customers under the EX-1 rate customers during both periods.[41] Therefore, as staff's witness states, ca-

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[37] PSC Brief Opposing Exceptions, p. 23.

[38] *Id.*

[39] CIG Brief on Exceptions, p. 46.

[40] *Id. citing* Exhibit Nos. 45 and 50.

[41] Exhibit 172 at 35. (Staff's witness stated that peak day usage under Rate Schedule EX-1 is four times greater than average daily

pacity is available and is used to provide service to interruptible customers during peak periods.[42]

In *Texas Eastern Transmission Corporation*, 37 FERC ¶ 61,260 (1986) (*Texas Eastern*), the Commission held that interruptible services use the same pipeline capacity as firm services. Interruptible services should therefore contribute a fully allocated portion of the fixed costs of providing such capacity.[43] Furthermore, in *Texas Eastern*, the Commission held that because both demand and commodity fixed costs are incurred in providing capacity, there is no reason to exclude demand costs from the interruptible transportation rate.[44] In *Texas Eastern*, interruptible transportation rates were at issue. However, the Commission has found that the same reasoning would apply to interruptible sales rates.[45]

The Commission finds that the interruptible customers should bear a portion of all fixed costs, since interruptible customers use this service, and CIG has incurred costs to own, maintain, and operate those facilities.[46] This is consistent with the Commission's decision in *Texas Eastern*.[47]

The Commission rejects Mountain Fuel's argument that the EX-1 service is an interruptible and potentially unreliable source of gas, and cannot properly be priced to include costs assigned to a firm demand charge. As the Commission stated in *Texas Eastern*, *supra*, the 100 per-

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purchases (based on 1984 annual purchases and the 1984-85 three-day peak) under EX-1).

[42] *Id.*

[43] *Texas Eastern* at pp. 61,698-705 (1986).

[44] *Id.*

[45] *Consolidated Gas Transmission Corporation*, 38 FERC ¶ 61,150, at 61,398 (1987).

[46] *Texas Eastern* at p. 61,702.

[47] *Id.* at 61,703.

cent load factor rate—recognizes the inferior nature of interruptible service.[48] The per unit charge for a firm customer will only match that of the 100 percent load factor rate if that firm customer fully utilizes its entitlement. If the firm customer does not use the full entitlement, its per unit cost will be higher; if neither firm nor interruptible customers take gas, the firm customer still must pay a demand charge or reservation fee. Therefore, the firm customer bears part of the risk even if it does not avail itself of the service which the interruptible customer chooses not to take.[49] Accordingly, the Commission shall reverse the ALJ on this issue.

B. Rate Schedule PS-1

Staff proposed a change to Rate Schedule PS-1, which is applicable to sales of gas from storage. The ALJ states that in support of this change staff offered the same argument it made regarding the EX-1 rate schedule, i.e., "peak related transmission facilities are used to provide this service and the rate design should reflect this situation and prevent unfair subsidization of the service by other customers." [50]

The ALJ noted that CIG also objected to this proposed change, on grounds similar to its arguments with respect to Rate Schedule EX-1, and in addition pointed out that the PS-1 service does not significantly rely on peak transmission facilities and therefore should not be assigned peak costs.[51]

The ALJ found that staff had not met its burden to show that the PS-1 rate schedule is unjust and unreason-

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[48] *Id.*

[49] *Id.*

[50] 35 FERC at p. 65,149 (1986).

[51] *Id.*

able and therefore rejected staff's proposal.[52] For the reasons set forth above, with respect to the EX-1 rate schedule, we will reverse the ALJ's finding and include demand costs in Rate Schedule PS-1.

On exceptions, staff states that its argument is the same as that advocated in regard to the EX-1 rate schedule. Staff contends that CIG asserts it is inappropriate to allocate transmission-related, demand costs to these customers because they do not significantly rely on peak transmission facilities.[53] However, staff states that it has shown that the weighted average miles associated with the PS-1 rate schedule deliveries is approximately 63 miles.[54] Staff argues that the ALJ's suggestion that using 63 miles of pipeline during peak periods is not significant is in error particularly when the service is rendered in and around Denver, Colorado, the heart of CIG's market.[55]

In its brief opposing exceptions, Natural states that it agrees with staff's position. Natural states that rate schedule PS-1 volumes must be transported to storage and therefore should share in demand costs associated with CIG's mainline service.[56]

PSC contends that the evidence shows that the use of transmission facilities in providing the PS-1 service in the Denver metro area is inconsequential.[57] PSC asserts that the PS-1 rate is applicable only to storage service from nearby Fort Morgan, not as staff's brief appears

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[52] *Id.*

[53] Staff Brief on Exceptions, p. 10.

[54] *Id., citing* Exhibit 172 at 33.

[55] Staff Brief on Exceptions, p. 10.

[56] Natural Brief Opposing Exceptions, p. 7.

[57] PSC Brief Opposing Exceptions at 23, *citing* Exhibit 45 at 8.

to assume, to service storage fields located further away from Denver which is actually provided under the P-1 and G-1 rates.[58]

CIG, in its brief opposing exceptions, contends that staff has the burden of proof on this issue and must prove both that the existing proposal is unjust and unreasonable and that staff's proposal is just and reasonable. CIG contends that the ALJ properly held that staff did not meet its burden.

Staff contends that the use of 63 miles of pipeline is significant use of the pipeline's system during peak periods.[59] This may very well be true. However, the Commission notes that service under the PS-1 rate schedule is available to any full requirements customer if the customer is purchasing gas from CIG under Rate Schedule G-1 or P-1.[60] Thus, PS-1 gas is available on a systemwide basis and its potential use during peak periods is significant. The Commission has held that a pipeline must build facilities sufficient to provide service at the time of peak demand and the company is entitled to recover those costs from the customers that imposed that demand.[61] To allow CIG's customers to receive peak service without payment of full demand-related costs is to grant them a subsidy at the expense of CIG's other customers. Therefore, the Commission will reverse the initial decision and allocate demand costs to the PS-1 service.

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[58] Brief Opposing Exceptions, p. 46.

[59] Staff Brief on Exceptions, p. 10. (The record also shows that three of the customers receiving PS-1 service were loctaed more than 110 miles from the Fort Morgan Storage Fields. (Exhibit 172 at 34)).

[60] CIG FERC Gas Tariff, Original Volume No. 1, First Revised Sheet No. 20.

[61] *Texas Eastern Transmission Corp.*, 37 FERC ¶ 61,260, at p. 61,698 (1986).

C. Rate Schedule F-1

The ALJ found that CIG should use a one-part commodity rate for Rate Schedule F-1. CIG excepts to the apparent exclusion of a charge for demand charges that CIG pays its pipeline suppliers. Natural opposed CIG and states that all charges should be recovered through a commodity rate and further states that the ALJ found that there are no demand costs to be properly reflected in a demand charge. Staff states that the ALJ was correct that "only production and gathering costs should be allocated to the F-1 service, a field sale service." [62]

The ALJ dealt with costs "exclusive of as-billed gas costs." [63] CIG is required to include its rolled-in system-wide gas purchase costs in its F-1 rate.[64] As proposed by CIG and supported by staff in its testimony,[65] GIC may classify its demand charges as billed to Rate Schedule F-1 using a demand charge. CIG should use a two-part demand charge as it does with respect to other rates. Accordingly, the Commission shall modify the initial decision on this issue.

III. Transportation Issue—Storage Costs

In determining whether storage costs should be allocated to transportation rates, the ALJ held that the parties in support of allocating storage costs to transmission services have not made a case showing any substantial benefits to transmission customers from the storage facilities on CIG's system which would warrant departure from the existing practice in designing CIG's rates.[66]

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[62] Brief Opposing Exceptions, p. 6.

[63] 35 FERC at p. 65,155.

[64] *Public Service Company of Colorado v. CIG,* 32 FERC ¶ 61,250 (1985).

[65] Exhibit 172 at 26.

[66] 35 FERC at p. 65,151.

Staff filed a brief on exceptions to the ALJ's decision on this issue. CIG, Western,and Southwest filed briefs opposing exceptions. For the reasons set forth below, the Commission reverses the finding of the ALJ.

The ALJ stated that in determining whether storage costs should be included in interruptible transportation rates, the Commission has examined the location of the storage facilities in relation to the pipeline's market.[67] The ALJ concluded that where storage facilities are not located near the service area, the need for pipeline capacity is not diminished because the pipeline must still have the ability to carry higher volumes to its service area during peak periods.[68]

Staff contends that proximity to major market areas is not determinative of whether storage benefits transportation, and maintains that system storage maximizes the utility of transportation plant and should be recovered in transmission rates.

Staff states that the Ft. Morgan and Latigo fields are close to CIG's major Denver markets.[69] Staff states that CIG's other fields, Boehm and Flank, while closer to CIG's supply areas, are located near major transmission lines and downstream from major customers of CIG.[70] Staff contends that this distinguishes CIG from the facts in *Transco*, as that company's storage facilities are located in its production area, upstream of all major sales areas.[71] Staff contends that the ALJ's conclusion that

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[67] 35 FERC at p. 65,151, *citing Tennessee Gas Pipeline Co.,* 28 FERC ¶ 61,025 (1984), and *Transcontinental Gas Pipe Line Corp.,* 30 FERC ¶ 61,322 (1985) (Transco).

[68] *Id.,* citing *Transco, supra.*

[69] Staff Brief On Exceptions, p. 10.

[70] *Id.* at 11.

[71] *Transcontinental Gas Pipe Line Corp.,* 33 FERC ¶ 63,035 (1985).

CIG's storage facilities do not mitigate the need for pipeline capacity is incorrect. Staff also contends that its testimony that CIG has insufficient gas supply deliverability to serve its customers, absent storage withdrawals, is unrebutted.[72] Staff argues that by injecting gas supplies into downstream storage facilities during the off-peak period, CIG is able to mitigate the need for supply deliverability and mainline transmission facilities.[73] Staff argues that all customers of CIG benefit from storage facilities by avoiding these costs.[74]

Southwest, Western, and CIG oppose staff's position and support the initial decision on this issue. CIG also argues that the inclusion of storage costs would institute a change in a pre-existing practice, and that it is the staff who must carry the burden of proof for its proposal for change.[75] CIG notes staff's contention that transportation customers benefit from CIG's storage, but states that the initial decision properly found that no such benefits have been shown on the record.[76] CIG contends that among other things, staff made no engineering study of CIG's system and storage facilities. CIG argues that the conclusions of staff's witness were merely general in nature and did not give any consideration to the location of storage on CIG's system.[77]

Staff's witness stated that all of CIG's customers benefited from CIG's storage facilities as they enhance CIG's peak day delivery, permit CIG to operate its system at a higher load factor than it would be able to absent such facilities and help CIG avoid the need to construct trans-

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[72] Staff Brief on Exceptions, p. 11.

[73] *Id.*

[74] *Id.*

[75] CIG Brief Opposing Exceptions, p. 47.

[76] *Id.*

[77] *Id.*

mission facilities.[78] Staff's witness also points out that CIG does not have sufficient mainline transmission capacity to serve peak day needs without withdrawing gas from storage.[79] Staff's witness contended that to allocate storage facility costs only to mainline sales and sales displacement customers is to disregard the integrated nature of CIG's system.[80]

The location of storage facilities in relation to production fields of market areas is not solely determinative of whether storage is beneficial to transportation customers. The Commission finds that CIG's customers do benefit from its storage facilities and therefore must share in the costs. Accordingly, we adopt staff's position on this issue.

IV. Throughput

Section 154.63(e)(2) of the Commission's regulations provides for a test period which consists of a 12-month base period, "adjusted for changes in revenues and costs which are known and are measurable with reasonable accuracy at the time of the filing . . ." [81] In its rate filing, CIG's sales volumes for its 12-month base period ended December 31, 1984, were 258.2 Bcf. CIG adjusted on an annualized basis the 258.2 Bcf downward to 206.2 Bcf for sales, and 9.7 for "sales displacement" transportation, for a total of 215.9 Bcf of test period volumes. The ALJ adopted CIG's test period volumes with the addition of 14.7 Bcf for sales to Cominco American Incorporated (Cominco).[82] CAG argues that CIG did not support its use of test period volumes in lieu of base period

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[78] Exhibit 172 at p. 37.

[79] *Id.*

[80] *Id.*

[81] 18 C.F.R. § 154.63(e)(2) (1987).

[82] There is no dispute over CIG's test period volumes at 66.7 Bcf for off-system transportation and 14.86 Bcf for gathering.

volumes, and that CIG's sales and sales displacement volumes are unreasonably low because of CIG's past imprudence. CAG asserts that the correct level of volumes is either CIG's base period sales of 258.2 Bcf or CAG's alternative proposal of 288.1 Bcf.[83] CAG also claims that imputed volumes should be used to avoid an inequitable shifting of costs to captive customers. Staff argues that the ALJ should have imputed sales displacement volumes of 52 Bcf as an incentive to CIG to expand capacity utilization. In addition, staff argues that CIG's decline in capacity since 1980 should be borne by CIG, and not its customers, because CIG is only entitled to a return on capital for facilities that are used and useful. CIG opposes the exceptions of CAG and the staff, and argues that the ALJ erred in including the Cominco volumes. Staff, CAG, and Public Service agree with the ALJ's inclusion of the Cominco volumes. Resolution of these issues is set forth below.

A. Test Year Adjustments

As stated above, CIG adjusted its base period volumes downward from 258.2 Bcf to 215.9 Bcf. CAG argues that CIG has violated the Commission's filing requirements because CIG has not shown that the downward adjustments were known and measurable at the time of its rate filing. Hence, CAG claims that CIG has not met its burden of proof as to the reasonableness of its proposed rates. CIG states that its test period adjustments were carefully explained in its evidence.[84] Those downward adjustments

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[83] CAG's figure was 242.5 Bcf for jurisdictional sales. The 288.1 Bcf figure is for total jurisdictional and non-jurisdictional sales and sales displacement transportation, and parallels the 258.2 figure for total sales.

[84] CIG also states that the Commission would have rejected CIG's rate filing if it had failed to comply with the Commission's regulations, and notes that the Commission did not reject its filing. The Commission finds that there is no significance to CIG's statement,

consisted of: (1) 6.6 Bcf as a correction for the colder-than-normal weather that occurred in CIG's service areas during the base period, (2) 8.5 Bcf for lost sales attributed to alternate supplies transported by CIG, (3) 23.0 Bcf attributed to gas supplies which CIG's customers will purchase directly without any transportation by CIG, and (4) 0.9 Bcf for minor adjustments to all sales to make the test period sales consistent with CIG's latest market information.[85] Contrary to CAG's statements, CIG's witness testified that the company was aware of the adjustments "at the time the filing was made in March of 1985." [86]

The Commission concludes that CIG's adjustment for the weather is inappropriate. The weather is not predictable enough so as to justify an adjustment to the test period data under the known and measurable standard for test period adjustments. The Commission also concludes that CIG's minor adjustments were improper because they were not sufficiently identified. The Commission concludes, however, that CIG has sufficiently justified the other downward adjustment of 8.5 Bcf and 23.0 Bcf.[87]

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since any Commission action herein is not dependent upon whether or not the Commission decided to summarily reject CIG's filing at the time it was filed.

[85] Exhibit 91 at 3, 4.

[86] *Id.* at 3; see also, Exhibit 15, which refers to the adjustments and was verified in April, 1985. CIG also refers to the allegedly lost sale of 14.7 Bcf to Cominco, which will be discussed separately in the text of this order.

[87] CAG cites *El Paso Natural Gas Co.*, 48 FPC 1022, 1030-31 (1972), in which the Commission rejected El Paso's use of an index figure to adjust its costs as "based on speculation and conjecture" and not "specified increases in El Paso's actual costs." The El Paso case is not controlling here because CIG has shown that its adjustments were related to specified lost sales, and CAG did not challenge CIG's measureemnt of the volumes.

B. Cominco Volumes

The ALJ adjusted CIG's throughput upward by adding 14.7 Bcf for sales to Cominco. He found that the Cominco load loss "was not 'known and measurable' at the time the filing was prepared; and, in fact, the CIG system retained the load." [88] CIG excepts.

CIG first argues that it retained the Cominco load "only under a short-term sales displacement transportation contract" and not as a sale, and has lost other sales. Next, it claims that it had good reason to exclude the Cominco sales at the time of filing because it was then negotiating with Cominco for the above transportation contract and had doubt as to whether Cominco would still be served by CIG. PSC states that CIG was making the field sales to Cominco when CIG made its filing in March of 1985 and is still transporting Cominco volumes purchased elsewhere. CAG objects to CIG's argument that the Cominco volumes should be excluded because it later lost other sales, because in March 1985, CIG did not know that it would lose the Cominco or other sales. Staff states that the initial decision "is a classic reading of the Commission's policy of 'known and reasonable', and the facts are admitted by CIG itself." [89]

The Commission agrees with the ALJ that CIG must include the Cominco sales. CIG's uncertainty as to whether it would retain Cominco's load is not enough to warrant its exclusion from CIG's volumes projections. The fact that it later lost other sales is irrelevant to the Cominco load issue. Accordingly, the Commission shall affirm the initial decision on this issue.

C. Imputed Volumes

Staff excepts to the ALJ's refusal to impute 52 Bcf of volumes to CIG's sales displacement transportation service. The ALJ based his decision on two points. First,

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[88] 35 FERC at p. 65,144.

[89] Brief Opposing Exceptions, pp. 24-25.

he observed that the Commission has only imposed a throughput condition on an interstate pipeline in connection with original or expanded certificate proceedings. Second, he found that, under traditional ratemaking principles, a utility is not denied recovery of the cost of underutilized capacity in the absence of imprudence. The ALJ found that neither CAG nor staff had shown that CIG was imprudent. He characterized the staff's proposal as a penalty and not an incentive, in that there was no showing that CIG could raise its throughput.

The staff's proposal would raise CIG's throughput to its 1980-1982 level and not to capacity.[90] Staff argues that the "issue is whether or not [CIG's] customers should bear the cost of underutilized capacity, and who shall bear the risk [of underutilizations] and increased unit costs."[91] It suggests the imputed levels as an incentive to CIG to regain its lost markets. Staff argues that if CIG cannot regain its sales, CIG and not its customers should bear the permanent loss. Staff maintains that its proposal is consistent with the principle that a "regulated company should only earn a return on a rate base that is used and useful."[92]

CIG states that the evidence shows that it cannot regain its sales losses and, therefore, the imputed volume levels would place it "in a position of having its pipeline property confiscated."[93] CIG also states that it has not acted imprudently and that its engineering and utiliza-

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[90] The 1980 load factor was approximately sixty percent. Tr. 1919, 1720, 1896, 1897, 1918.

[91] Brief on Exceptions, p. 5.

[92] *Id.* at 6.

[93] Brief Opposing Exceptions, p. 10. CIG notes that staff's volume level would give it an opportunity to earn only a 3 percent rate of return on equity. *Id.*, n.2.

tion analysis shows that its "facilities are fully used and useful to CIG's customers." [94]

The Commission disagrees with the ALJ that the Commission may only impute throughput volumes in a certificate proceeding or after a finding of imprudence. The Commission agrees with the staff that an appropriate question is whether the ratepayers should bear the cost of a pipeline's facilities that are not fully used and useful in the presence of unused capacity. However, the Commission finds that the instant record does not support staff's proposal. Accordingly, the Commission rejects staff proposal in this case.

D. Imprudence

CAG argues that CIG's base period volumes of 258 Bcf are unreasonably low because of CIG's past imprudent and preferential acts.[95] In particular, CAG alleges that CIG paid too much for tight sands gas purchased from affiliates in 1981 through 1984, that CIG's WACOG was extraordinarily high between 1981 and 1985, and that CIG's sales losses for that period were also extraordinary. CAG attributes the sales losses to partial requirements customers switching to other gas suppliers and industrial customers switching to other fuels. It concludes that those losses were price-related. CIG states that it could not have taken action to avoid the sales decline experienced since 1980, that CAG has shown no connection between the prices paid to affiliates for tight sands gas and CIG's overall sales level, and that, in any event, there was no imprudence in its pricing of tight sands gas purchased from affiliates.

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[94] *Id.* at 15, *citing* Exhibit 1. CIG was "designed to service the peak day and wintertime requirements of the Front Range of Colorado." *Id.* at 14.

[95] CAG does not allege that any of CIG's acts constitute fraud and abuse under Section 601(b) of the Natural Gas Policy Act. *See* CAG Brief on Exceptions, p. 21.

CAG claims that two amendments to agreements between CIG and its parent, Coastal, resulted in imprudent and preferential prices with respect to volumes purchased from Coastal and another affiliate, CIG Exploration. The first amendment was an agreement in May of 1981 to pay tight sands prices under section 107(c) of the NGPA. CAG states that this raised the price from 20 to 30 cents per Mcf to over $6.00 per Mcf without any reasonable justification. In fact, CAG claims that CIG had no need for the gas as evidenced by its "dumping oversupplies" and "turning away less expensive supplies from other sources." [96] CIG claims that in 1981 it was projecting substantial gas supply deficiencies in 1983 and beyond, that it offered incentive pricing to a non-affiliated company, Belco Development Corporation (Belco), and that since October of 1983 CIG has had one of the lowest WACOG's among pipelines.

The second amendment was an agreement in September of 1984 to pay $4.14 per MMBtu for the tight sands gas acquired from the CIG affiliates.[97] CAG claims that this price was imprudent because it exceeded prices paid to independent producers such as Belco ($3.80 per MMBtu) and others ($3.50 for unaffiliated producers as a group). CAG alleges that there was "never any arm's length bargaining between buyer and seller," [98] and objects to the methodology used by B.H. Huddleston and Co. to derive the $4.14 per MMBtu price.[99] CIG asserts that in addi-

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[96] *Id.* at 25.

[97] The amendment applied to the period from April 1, 1984 through March 30, 1985.

[98] CAG Brief on Exceptions, p. 36.

[99] B.H. Huddleston and Co. used averages of prices paid by CIG to all non-affiliated producers of section 107 gas. CAG claims that non-renegotiated prices should not have been included in determining the renegotiated price. CAG notes that B.H. Huddleston and Co. had a long-standing relationship with Coastal and did its analy-

tion to the price reduction, the 1984 contact amendment provided for a waiver of some $100 million in take-or-pay obligations, and gave CIG the unusual right to redetermine price annually. CIG also states that this redetermination resulted in a price of $2.75 per MMBtu on sections 102, 103 and 107 gas, effective April 1, 1985.

It is undisputed that CIG has suffered a significant sales decline since 1980.[100] Moreover, the loss is attributable to decreased pipeline purchases, such as by Natural, and to gas "displacement by coal, self-help gas, and spot sales in the electric utility and industrial sector."[101] In addition, the record shows that CIG's WACOG increased from $1.15 per Mcf in 1979 to $2.58 per Mcf in 1980, to $2.99 in 1981 and, thereafter, declined to $2.92 in 1982, $2.55 in 1983, and $2.45 in 1984.[102] CAG argues that CIG's sales volumes are unreasonable in that the volume "losses on which they are based were driven by CIG's own imprudence."[103] CIG denies any imprudence and asserts that "even if CIG had been imprudent, no sales effect has been shown."[104]

The Commission first observes that CAG does not allege that CIG's acts constituted fraud and abuse under section 601(b) of the NGPA. Moreover, CAG does not claim that CIG acted imprudently with respect to its purchases

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sis at the request of Coastal's President. CAG does not allege any affiliation between Coastal and B.H. Huddleston and Co. or question the independence of B.H. Huddleston and Co.

[100] CIG Brief Opposing Exceptions, p. 16; *see also*, Exhibit 125.

[101] Brief Opposing Exceptions, p. 16; *see also*, Exhibit 97. The loss attributable to the above decreases is 71 percent of CIG's loss from 1980-1984 (Exhibit 97 at 5).

[102] Exhibit 124 at 36. The years referred to reflect an October 1 effective date.

[103] Brief on Exceptions, p. 45.

[104] Brief Opposing Exceptions, p. 22.

of tight sands gas from its affiliates after March of 1985.[105] CAG's claim is that CIG's prior imprudent acts caused throughput losses which continue today and should be remedied by the imputation of throughput. CAG suggests no other remedy.

The Commission finds that CAG has not shown that CIG acted imprudently or preferentially in entering into the 1981 tight sands amendment. The Commission finds it significant that CAG does not challenge CIG's dealings with non-affiliated producers of tight sand gas and that CIG offered the 1981 amendment to Belco, a non-affiliated major gas supplier in the same area.[106] In addition, the Commission is unable to agree with CAG that CIG executed the 1981 amendment in the face of a known projected gas surplus.[107]

The Commission finds no inherent inconsistency in CIG's attempting to sell more gas in 1981,[108] and projecting gas supply deficiencies thereafter.[109] The Commission also views the various inconsistent gas supply projections in the record [110] as inconclusive as to whether it was imprudent for CIG to execute the 1981 amendment.[111] The Commission concludes that CIG's 1981

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[105] B.H. Huddleston & Co.'s recommended price for the period April 1, 1985 to March 31, 1985 was $2.75 per MMBtu. Exhibit 139.

[106] Exhibit 51 at 5; Exhibit 71.

[107] CAG claims that CIG received no consideration for agreeing to the price increase because the producers were already obligated to develop the acreage "in accordance with prudent operating practices." Exhibit 57 at 6. However, the producers did agree to develop a fixed number (i.e., 15) of wells in 1981. Exhibit 69 and 70.

[108] Exhibit 124 at 44-45; Exhibit 65.

[109] Exhibit 51 at 4-5; Exhibit 52 (1981 Gas Balance Report).

[110] *Compare* Exhibit 52 (1983 deficiency) and Exhibit 192 (1982 gas balance summary) (1983 surplus and 1984 deficiency).

[111] The Commission also finds it irrelevant whether or not new reserves were actually developed.

amendments were not shown to be imprudent or preferential.[112]

The Commission is also unable to find that CIG acted imprudently or preferentially with respect to the 1984 amendment. First, as pointed out by CIG, it received valuable concessions in addition to the price reduction in the form of take-or-pay relief and the right to annual redeterminations.[113] Second, the price of $4.14 per MMBtu was based on a recommendation by B.H. Huddleston & Co. While CAG questions the methodology and the relationship between that firm and Coastal, there is no allegation that B.H. Huddleston was not an independent firm. The Commission concludes that CIG's 1984 amendments were not shown to be imprudent or preferential.[114]

The Commission agrees with CIG that even assuming that CIG acted imprudently with respect to its 1981 and 1984 tight sands amendments and purchases thereunder, there is no evidence that the related increases in costs have caused CIG's WACOG to be non-competitive.

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[112] CAG observes that in 1981 CIG gave notice to Panhandle that CIG was reducing its purchases of Panhandle's gas to zero as of May 1, 1982 (Exhibit 68). CAG argues that the turning back of this supply at Panhandle's WACOG indicates the imprudence of entering into the 1981 amendment. CIG's agreement with Panhandle is an exchange agreement which gave CIG the right to purchase up to 25 percent of the volumes Panhandle delivered into the CIG system (Exhibit 66). The Commission notes that the purchase price was not Panhandle's WACOG for all gas but Panhandle's weighted average purchase price from its "source of supply" for the exchange gas, plus adjustments for Panhandle's payments under prepayment or take-or-pay obligations, and Panhandle's gathering and transmission costs (Exhibit 66 at 14-15). Hence, CAG's comparison of Panhandle's gas at its WACOG to the tight sands gas is incorrect and of no moment.

[113] Exhibit 72.

[114] The Commission notes that the price renegotiated with Belco was $3.80.

There is nothing in the record which indicates that CIG would have retained any sales in the absence of the alleged imprudent amendment.[115] In fact, CAG's case consists of nothing more than a comparison of CIG's sales decline to the decline in U.S. gas consumption [116] and a statement that the sales were lost because of CIG's high prices. It is evident that CAG's case would do no more than convict CIG of doing worse than the national average. There was no showing that CIG could have managed its aggregate purchasing practices to avoid the load loss.[117] Indeed, the record shows that Natural, the alleged cause of much of the pipeline purchasers' load loss,[118] was purchasing significant quantities of gas in 1985 from other sources at prices in excess of CIG's commodity rate.[119] Moreover, the Commission observes that CAG's claimed 1984 increase in CIG's WACOG of $5.9 million (owing to the 1984 tight sands amendments) has a slight impact on a WACOG of $2.45 per Mcf and sales of 273 Bcf.[120] The Commission concludes that no con-

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[115] CAG's witness testified that he did not quantify the relationship between the questioned management decisions and lost sales. Tr. 1287, 1327. The record indicates that at least 29 Bcf of CIG's 1980 through 1984 sales load loss of 140 Bcf accrued before the 1981 tight sands amendment (Exhibit 125).

[116] From 1980 to 1984, the U.S. gas consumption declined 11.7 percent while CIG's sales declined 29.9 percent.

[117] CAG's witness testified that he did not analyze CIG's overall gas purchasing practices (Tr. 1319). The record indicates that the 66 Bcf load loss from 1982 through 1984 occurred when CIG's WACOG was declining (Exhibits 125 and 124 at 36).

[118] See Exhibit 97 at 16.

[119] Tr. 1421.

[120] CAG subtracted the $3.50 that CIG was paying unaffiliated producers from $4.14. Brief on Excetpions, p. 39. The impact would be approximately two cents per Mcf. CAG has not claimed any imprudence by CIG with respect to its purchases of tight sands gas from non-affiliated producers, such as Belco.

nection on this record has been shown between CIG's tight sands amendments in 1981 and 1984 and its load losses.

The Commission concludes that CAG has not shown that CIG acted imprudently with respect to either the 1981 or the 1984 amendments or purchases thereunder and, even assuming imprudence, that CAG has shown no causal connection between CIG's tight sand purchases from affiliates and its load loss.[121] Accordingly, the initial decision is affirmed on this issue.

E. Cost Shifting

CAG also argues that there are policy reasons for not giving effect to CIG's test period volumes. It claims that use of those volumes would insulate CIG from the risk of sales losses at the expense of captive customers. CAG claims that imputed volumes are particularly needed in this case because of the decrease in shareholders' risk caused by CIG's market rate of return on equity and the adoption of the MFV rate design method in lieu of the previously employed *United* method.[122] The Commission rejects CAG's argument. The Commission observes that cost shifting to captive customers is ameliorated under the MFV method by the use of the D-2 component, and that CIG is at risk with respect to sales load losses under the rates set in this docket.

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[121] Accordingly, the Commission has no need to fashion a remedy for imprudence. The Commission finds that CAG's proposed imputation of 45 Bcf for sales to Natural is problematical in light of the lack of evidence of any link between CIG's loss of Natural's business and a WACOG increase caused by tight sands affiliate purchases. Indeed, in 1985, Natural bought gas at prices above CIG's price. Tr. 1421.

[122] Under the United method, 75 percent of CIG's fixed costs were at risk in the commodity component of its rates. The MFV method shifts some of these costs to the demand component where they are not at risk.

V. Minimum Bill to Natural

CIG excepts to the ALJ's elimination of its 90 percent cost minimum bill in CIG's Rate Schedules F-1 and H-1 for service to Natural. Under Rate Schedule F-1, CIG delivers gas to Natural in the field. Under Rate Schedule H-1, CIG delivers gas to Natural at an interconnection between CIG's mainline and Natural's mainline. The F-1 and H-1 deliveries are covered by a composite service agreement. The minimum bill applies to the aggregate F-1 and H-1 contract quantities, and deficiencies are billed at the rate stated in Rate Schedule F-1. He found that:

> CIG's minimum commodity bills at the proposed 90 percent level are not shown to be just and reasonable. No party has properly supported a minimum bill at an intermediate level. Accordingly, CIG's minimum commodity bill provisions in H-1 and F-1 as proposed are rejected.[123]

CIG argues that the burden of proof was on the participants proposing the elimination or modification of its minimum bill, which has existed since 1958, and that they did not meet their burden. In addition, CIG asserts that the record supports a finding that it is entitled to retain the minimum bill under the Commission's minimum bill criteria. Colorado Springs also excepts to the ALJ's decision and incorporates by reference CIG's brief on exceptions on this issue. Staff and Natural support the ALJ's decision. They assert that CIG did not meet the Commission's standards for retention of a minimum bill.

The Commission agrees with CIG that the burden of proof with respect to its minimum bill rested on Natural and the staff because CIG proposed no change to its minimum bill.[124] We discussed this issue in *Transwestern*

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[123] 35 FERC at p. 65,155.

[124] *Transcontinental Gas Pipe Line Corp.*, 40 FERC ¶ 61,188, at p. 61,589 (1987), *citing Sea Robin Pipeline Co. v. FERC*, 795 F.2d

Pipeline Co., where we stated that once a showing of anticompetitiveness was made, the burden of going forward was shifted to the pipeline to justify retention of its minimum bill.[125] Natural's witness testified that CIG's minimum bill is anticompetitive in that a minimum bill means that "alternate supply sources must be priced lower than CIG's commodity rate by at least the amount of the minimum commodity bill before the two purchases are equally attractive to Natural." [126] He concluded that "the legitimate competitive advantage which would ordinarily accrue to the low cost supplier is eliminated." [127] That is sound theory. Moreover, CIG admits it is in a "gas over supply situation." [128] That is sufficient to shift the burden of going forward to CIG to justify retention

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182 (D.C. Cir. 1986); *ANR Pipeline Co. v. FERC*, 771 F.2d 507 (D.C. Cir. 1985); and *Public Service Commission of New York v. FERC*, 642 F.2d 1335 (D.C. Cir. 1980), *cert. denied*, 454 U.S. 897 (1981).

[125] *Transwestern Pipeline Co.*, 36 FERC ¶ 61,175, at pp. 61,439-41 (1986), *aff'd, Transwestern Pipeline Co. v. FERC*, 820 F.2d 733 (5th Cir. 1987). There, we stated:

> The burden of persuasion is on the parties challenging the minimum bills and remains there. The initial burden of producing evidence is also on these parties. They satisfy this burden by showing that the inclusion of a minimum bill in Transwestern's rate schedules will indeed cause competitive harm. Once this is shown the burden of production shifts to Transwestern to justify retaining its minimum bills by showing that they are necessary to achieve an objective meriting recognition under the antitrust laws or the Natural Gas Act. In Opinion No. 238 we found that the "probable consequence" of including a minimum bill in Transwestern's rate schedules would be to adversely affect competition. Accordingly, it was incumbent on Transwestern to justify retaining its minimum bills.

36 FERC at pp. 61,439-40 (Footnotes omitted).

[126] Exhibit 140 at pp. 10-11.

[127] *Id.* at 11.

[128] Brief on Exceptions, p. 20.

of its minimum bill. Indeed, CIG was well aware that its minimum bill was in issue and submitted evidence on the issue.[129]

The Commission finds that CIG's minimum bill is not justified under the Commission's minimum bill criteria applicable in this case. In *Transwestern Pipeline Co.*,[130] we noted the three Seaboard[131] factors which generally justify a minimum bill. They are:

> First, a minimum bill may be justified as a means of protecting the pipeline against the risk of not recovering the fixed costs in the commodity component. Second, a minimum bill may be justified as a means of protecting full requirements customers from bearing a disproportionate share of the fixed costs resulting from swings off the system by partial requirements customers. And third, a minimum bill may be justified as a means of protecting customers from take-or-pay liabilities the pipeline might otherwise incur.[132]

CIG does not meet the first justification because under its modified fixed-variable rate design method a minimum bill to assure recovery of fixed costs is unnecessary.[133] The Commission also finds that CIG does not meet the second justification because the benefits to ratepayers of placing the pipeline at risk for the production and gathering and limited transmission and storage costs here in-

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[129] Exhibit 50.

[130] 32 FERC ¶ 61,009 (1985), *reh'g denied*, 36 FERC ¶ 61,175 (1986) aff'd, 820 F.2d 733 (5th Cir. 1987).

[131] *Atlantic Seaboard Corp.*, 38 FPC 91 (1967), *aff'd*, 404 F.2d 1268 (D.C. Cir. 1968).

[132] 32 FERC at p. 61,031.

[133] *See Transcontinental Gas Pipe Line Corp.*, 40 FERC ¶ 61,188, at p. 61,590 (1987) for a discussion of the rationale that the fixed costs in the commodity component should be at risk.

volved outweigh the potential detriment of shifting those costs to full requirements customers.[134] In addition, the Commission observes that CIG may compete in the transportation arena to recapture any lost sales to Natural and may take other steps to price its gas competitively.[135] Last, the Commission finds that CIG has not met the third justification because it has shown no specific connection between its minimum bill and its take-or-pay obligations. Accordingly, the Commission shall eliminate CIG's minimum bill.[136]

The Commission will not eliminate CIG's minimum bill retroactively to the effective date of the rates herein. Therefore, the Commission concludes that CIG's minimum bill should be eliminated prospectively from the date of this order.[137]

VI. Conclusion

For the reasons set forth in the text of this decision, the Commission shall affirm in part, and reverse in part, the initial decision issued by the ALJ in this proceeding on May 13, 1986.

The Commission orders:

(A) The initial decision issued in this proceeding is modified in part and affirmed in part, consistent with

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[134] *Cf. Id.*

[135] *See ANR Pipeline Co.*, 37 FERC ¶ 61,263, at p. 61,751 (1986), *reh'g denied,* 38 FERC ¶ 61,221 (1987).

[136] The Commission finds that its order in *Colorado Interstate Gas Co.*, 27 FERC ¶ 61,315 (1984) does not have, as claimed by CIG, a *res judicata* effect here. In that order, the Commission directed "the staff to consider the proper level of fixed cost recovery for CIG's minimum commodity bill in CIG's next section 4 rate case." 27 FERC at p. 61,583. Such a level includes a zero level, that is, no minimum bill.

[137] The Commission's decision with respect to the issue of Cost Allocation and Rate Design will also be applied prospectively.

the terms of this order. All exceptions not specifically addressed herein are denied.

(B) Within 15 days following the issuance of this order, CIG shall file revised rate schedules to comply with the findings and conclusions of this decision.

(C) Within 15 days of the date CIG files revised rate schedules pursuant to Ordering Paragraph (B), CIG shall file a refund report with this Commission showing the calculation and payment of any refunds that become necessary as a result of the action taken in this order.

APPENDIX D

FEDERAL ENERGY REGULATORY COMMISSION

Docket No. RP85-122-004

COLORADO INTERSTATE GAS COMPANY

Opinion No. 290-A; Opinion and Order Denying Rehearing and Granting Clarification

(Issued April 20, 1988)

Before Commissioners: Martha O. Hesse, Chairman; Anthony G. Sousa, Charles G. Stalon, Charles A. Trabandt.

[Note: Opinion No. 290 affirming in part, and reversing in part Initial Decision issued November 28, 1987, appears at 41 FERC ¶ 61,179.]

[Opinion No. 290-A Text]

On November 18, 1987, the Commission issued Opinion No. 290 in this proceeding.[1] In that Opinion, the Commission affirmed in part and reversed in part an initial decision of an administrative law judge (ALJ) with respect to a number of issues.[2] On December 18, 1987, Colorado Interstate Gas Company (CIG), Natural Gas Pipeline Company of America (Natural), and Western Gas Processors, Ltd. (Western Gas) filed requests for rehearing of Opinion No. 290. On December 21, 1987,

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[1] *Colorado Interstate Gas Co.*, 41 FERC ¶ 61,179 (1987).

[2] *Colorado Interstate Gas Co.*, 35 FERC ¶ 63,043 (1986).

Mountain Fuel Resources, Inc. (Mountain Fuel) filed a request for clarification or, in the alternative, rehearing of Opinion No. 290. Mountain Fuel's request was filed 33 days after the date of Opinion No. 290. Section 19(a) of the Natural Gas Act provides only 30 days for the submission of an application for rehearing.[3] Therefore, Mountain Fuel's request for rehearing is rejected. Its request for clarification will be considered, however. On December 28, 1987, Western Gas filed a request to supplement its rehearing petition. Its request is denied as a rehearing application but will be considered as a petition for clarification. The issues raised in the requests for rehearing and clarification involve CIG's method of cost classification, allocation and rate design, its minimum bill to Natural, its throughput, its H-1, EX-1, and EUS-1 rates, proposed Rate Schedule PR-1, various cost-of-service issues, and the Commission's assignment of storage costs to CIG's transportation rates.

With respect to some issues, the requests for rehearing repeat arguments that were addressed in Opinion No. 290 or were considered in conjunction with the summary affirmations of the ALJ's decision. Accordingly, because the arguments are repetitive and present nothing new that leads the Commission to change its prior findings, the Commission, without additional comment, denies rehearing with respect to: Rate Schedule PR-1, overhead charges, rate of return, employee benefits and pensions, windfall profits tax, unfunded tax liability (South Georgia add-back), and regulatory commission expense.

EUS-1 Clarification

In Opinion No. 290, the Commission summarily affirmed the ALJ's determination that the record evidence contained insufficient support for CIG's proposed end use

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[3] 15 U.S.C. § 717r(a) (1982).

(EUS-1) rate increase for interruptible on-system transportation. CIG's exceptions regarding the comparability of on- and off-system transportation services did not overcome the record's lack of cost-based evidentiary justification for the proposed rate increase.

In its request for rehearing, CIG states that it will not pursue the EUS-1 rate issue if the determination in Opinion No. 290 to prospectively apply the cost allocation and rate design holdings[4] also applies to the EUS-1 rate determination. If prospective application does not apply, CIG seeks rehearing for the reasons set forth in its Brief on Exceptions. CIG notes that the EUS-1 Rate Schedule applied to a limited number of transportation transactions for end-users under Commission regulations that were eliminated by Order No. 436 [*FERC Statutes and Regulations, Regulations Preambles 1982-1985* ¶ 30,665]. However, it states that subsequent to the closing date in this proceeding, the Commission issued certain certificate orders that required application of the EUS-1 rate to transportation services for which that rate schedule did not apply. CIG seeks rehearing of the applicability of the EUS-1 Rate Schedule to transactions under those certificates if prospective application does not apply to the EUS-1 rate.

Western Gas requests that the Commission clarify[5] that footnote 137 in Opinion No. 290 applies to the cost allocation and rate design issues discussed in the body of the Opinion and not to the summary affirmation of the ALJ's rejection of the proposed EUS-1 rate change. It suggests that CIG seeks prospective application with respect to the EUS-1 rate because, as CIG noted, several

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[4] 41 FERC at p. 61,469, n.137.

[5] As noted above, Western Gas' request to supplement its rehearing request is being treated as a petition for clarification. CIG has responded to the matters contained therein.

certificate proceedings were made subject to determination of the appropriate rate levels in this docket. Western Gas argues that CIG's position constitutes an attempt to avoid refund obligations that will arise by the Commission's affirmation of the ALJ with respect to EUS-1 rates, and which it clearly knew could result from the order [6] accepting its rate filing and suspending the rates and tariffs proposed to become effective September 28, 1985, subject to refund.

Western Gas is correct in its reading of footnote 137. The footnote, by clearly referring to the "Cost Allocation and Rate Design" section of the Opinion, applies prospective application only to those issues specifically discussed in that section of the Commission's decision. It does not apply to rejection of CIG's proposed increases to its EUS-1 rate. Because the ALJ correctly found that CIG had not shown the proposed EUS-1 rate increases to be just and reasonable, and because on exceptions CIG did not overcome the record's lack of justification for the proposed increase in the EUS-1 Rate Schedule, the proposal was appropriately rejected, and refunds are warranted as ordered by the ALJ and Opinion No. 290.[7] By misreading footnote 137 and relying on arguments previously submitted and considered on exceptions, CIG has not convinced the Commission to change its position with respect to rejection of the proposed change in EUS-1 rates or refund. Accordingly, rehearing is denied.

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[6] 31 FERC ¶ 61,096, at p. 61,182 (1985).

[7] CIG did not specifically identify the certificate proceedings that would warrant rehearing if prospective application did not apply to the EUS-1 issue. (Western Gas did attempt to identify some of the proceedings to which CIG might have had reference.) In any event, this is not the appropriate forum to discuss the effects of the conclusions with respect to the ENS-1 rate on other issues in other dockets. CIG should raise those issues in the relevant certificate proceedings.

MFV Rate Design

The parties requesting rehearing of Opinion No. 290 have raised no new arguments which would cause the Commission to reconsider its implementation of the Modified Fixed-Variable (MFV) rate design methodology for CIG's system. However, both Natural and CIG request that if the Commission retain the version of MFV rate design set forth in Opinion No. 290, it should clarify the method by which CIG is to establish its annual (D-2) billing determinants. The Commission will grant these requests for clarification as discussed below.

Natural and CIG present methods by which the D-2 billing determinants might be established pursuant to Opinion No. 290. Natural, contends that Opinion No. 290 requires that annual volumes are the appropriate measure for establishing the D-2 billing requirements. However, Natural states that if its view is incorrect, the Commission should clarify Opinion No. 290 to provide that the D-2 billing determinants should be based on a reasonable approximation for annual volumes. Natural contends that on an ongoing basis the D-2 billing determinants should be established by customer nominations. CIG contends that D-2 billing determinants should be established by use of annual contract entitlements. CIG believes that the contract entitlements established in Docket No. CP85-381 represent current capacity requirements on CIG's system and therefore should be used to establish the D-2 billing determinants.

The Commission will require that the D-2 billing determinants be established by the use of the annual entitlements nominated by CIG's customers. This action is consistent with the Commission's determination in Opinion No. 260-A and other cases that the D-2 component should be based on the annual right to demand service.[8]

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[8] *See, e.g., Transcontinental Gas Pipe Line Corp.*, 37 FERC ¶ 61,328 (1986) (Opinion No. 260), *reh'g granted in part and de-*

The Commission is concerned that the existing annual entitlements nominated by CIG's customers and approved by the Commission in 1985,[9] may no longer accurately reflect the current gas supply needs of CIG's customers. Therefore, the Commission will require CIG to permit its customers to select the amount of annual service they wish to purchase and nominate that amount within 30 days of the issuance of the instant order. Further, the Commission will require CIG to accept the renominations from its customers if such nominations are less than or equal to the customer's maximum daily entitlement times 365 and to file rates developed upon those nominations within 45 days of the issuance of the instant order.[10]

Production and Gathering Costs

In the Initial Decision, the ALJ stated that the treatment of gathering and production costs has been thoroughly treated by the Commission in *Texas Eastern* [11] and further stated that no reason had been given that would cause the Commission to alter its established treatment of such costs. On rehearing, CIG has presented no new arguments which would cause the Commission to change its long standing policy against classifying production and gathering costs to the commodity component of a pipe-

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nied in part, 40 FERC ¶ 61,188, at p. 61,585 (1987) (Opinion No. 260-A); *Texas Eastern Transmission Corp.,* 32 FERC ¶ 61,056, at p. 61,153 (1985); *Natural Gas Pipeline Co. of America,* 25 FERC ¶ 61,176, at pp. 61,483-85 (1983), *reh'g denied,* 26 FERC ¶ 61,203 (1984), *aff'd in part sub nom., Northern Indiana Public Service Co. et al. v. FERC,* 782 F.2d 730 (7th Cir. 1986).

[9] *Colorado Interstate Gas Co. et al.,* 32 FERC ¶ 61,481 (1985).

[10] *See Columbia Gas Transmission Corp.,* 38 FERC ¶ 61,342 (1987); *Texas Eastern Transmission Corp.,* 32 FERC ¶ 61,056 (1985); *United Gas Pipe Line Co.,* 40 FERC ¶ 61,066 (1987).

[11] *See Texas Eastern Transmission Corp.,* 30 FERC ¶ 61,144, at p. 61,269 (1985), *reh'g granted in part and denied in part,* 32 FERC ¶ 61,056 (1985).

line's rates. However, CIG has correctly pointed out that neither Opinion No. 290 nor the Initial Decision has addressed the issue of whether the carrying charges on gas prepayments should be allocated to the demand component of its rates. Consistent with Commission precedent, the Commission finds that carrying charges on gas prepayments are production related costs and are to be classified to the commodity component for the same reasons as those given above.[12] Accordingly, CIG's request for rehearing is denied.

Transportation-Allocation of Storage Costs

On rehearing, CIG claims that the Commission erred by reversing the ALJ's determination that staff had not met its burden of proof in proposing to allocate storage costs to transportation customers. CIG also contends that the ALJ properly relied on *Transco*[13] and *Tennessee*[14] to determine whether storage costs should be allocated to transportation customers based on a location theory, and that the Commission erred by concluding that all customers benefit from storage facilities without analyzing the existence or level of such benefits.

CIG also contends that the allocation of storage costs will make its transportation rate less competitive and increase the risk that it will not earn its allowed rate of return. CIG further contends that the Commission should not determine the rate design for generally applicable transportation rate schedules because its presently effective rate schedules were not before the Commission in this proceeding. CIG contends that Docket No. RP87-30 is the appropriate docket for its generally applicable rate

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[12] *See Transcontinental Gas Pipe Line Corp.*, 40 FERC ¶ 61,188, at p. 61,591 (1987).

[13] *Transcontinental Gas Pipe Line Corp.*, 30 FERC ¶ 61,322 (1985).

[14] *Tennessee Gas Pipeline Co.*, 28 FERC ¶ 61,025 (1984).

schedules and that the Commission should confine its holding in the instant case to the specific "X-Rate" schedules that were before it when the record was compiled. Further, CIG requests that the Commission affirm that its decision on the allocation of storage is prospective and without prejudice to a determination on the same issue in Docket No. RP87-30.

Western also contends that the Commission erred in Opinion No. 290 by allocating storage costs to transportation. Western argues that to assign storage costs to transportation rates the Commission must show that transportation customers are directly benefited by storage, which is a function of the location of the storage facilities. Western alleges that, contrary to providing a benefit to transportation customers, storage in many circumstances is a detriment. Western states that the storage facilities at issue are located where use of the mainline transmission facilities for injections and withdrawals is necessary thereby creating an impediment to increased transportation. Western contends the record shows that CIG's storage was constructed to meet peakday sales needs and that it continues to serve in that role only.

Western requests that if the Commission does not grant rehearing of Opinion No. 290 on this issue that it clarify Opinion No. 290 to state that CIG should allow transportation customers to schedule gas into storage during the summer and out during the winter, or whatever other times are requested and capacity is available.

The Commission held in Opinion No. 290 that the location of storage facilities in relation to production fields or market areas is not solely determinative of whether storage is beneficial to market customers.[15] The record in this proceeding clearly shows that CIG's transportation customers benefit from storage.[16] Therefore allocation of

[15] 41 FERC ¶ 61,179, at p. 61,460 (1987).

[16] Exhibit No. 172 at pp. 36-37.

storage costs only to sales customers would disregard the integrated nature of CIG's system and allow transportation customers to pay less than a fully allocated cost for benefits received. As the Commission held in *Columbia Gulf Transmission Company*, 39 FERC ¶ 61,335 (1987) (Columbia Gulf) system storage is often constructed as an inexpensive alternative to pipeline transmission capacity, transportation customers benefit because of lower transmission costs and the operational flexibility afforded by storage.[17] Therefore, the Commission will deny Western's and CIG's requests for rehearing on this issue, since the parties have raised no arguments which persuade us to change the holding on this issue in Opinion No. 290. However, the Commission will clarify Opinion No. 290 as to the effective date of this change. Since allocating storage costs to transportation service, constitutes a change in the method CIG has traditionally used to allocate storage costs, this change will be made on a prospective basis. Further, if CIG accepts the blanket transportation certificate as authorized by the Commission's March 28, 1988 order in Docket No. CP86-589 *et al.* [42 FERC ¶ 61,380], Western can obtain access to CIG's system storage to the extent available.[18] However, to the extent Western's request contemplates contract storage, CIG does not have any such certificated authorization or rates in effect to provide that service, and therefore cannot currently do so.

Rate Schedule EX-1

CIG contends that the Commission did not adequately explain its rationale in finding that staff had met its burden of proof in showing that Rate Schedule EX-1, as

[17] *Columbia Gulf Transmission Co.*, 39 FERC at p. 62,049 (1987); *see ANR Pipeline Co.*, 37 FERC ¶ 61,263, at p. 61,740 (1987) (storage is traditionally allocated on a system-wide basis on the premise that storage is part of an integrated operation).

[18] *See* 18 C.F.R. Part 284 (1987).

proposed by CIG, was unjust and unreasonable. We disagree. The Commission's discussion in Opinion No. 290 shows that the proposed use of only a commodity rate for Rate Schedule EX-1 was unjust and unreasonable because it did not allocate sufficient demand-related fixed costs to customers using pipeline capacity during peak periods. Moreover, as we said in *Texas Eastern*, the 100 percent load factor rate recognizes any inferiority in interruptible service because if the interruptible customer does not use the service, it will pay nothing.[19] In addition, the 100 percent load factor rate is a fully allocated, compensatory rate for an interruptible service.[20] CIG has advanced no arguments on rehearing which persuade the Commission to find the contrary.

The Commission will clarify its imposition of the 100 percent load factor charge for Rate Schedule EX-1 service in regard to the correct base rate to be used to establish the 100 percent load factor rate. Mountain Fuel requests clarification of this point because as a P-1 Rate Schedule customer, Mountain Fuel contends that if the G-1 Rate Schedule is used as the base rate for caucula-tion of the 100 percent load factor rate, Mountain Fuel will pay more for interruptible service (i.e. overrun) than for firm service (under the P-1 Rate Schedule).

CIG has had the long standing practice of providing a demand charge differential between its Rate Schedule P-1 (pipeline customers) and its Rate Schedule G-1 (distributor customers) whereby the former customers pay a lower demand charge than the latter customers. This situation results in a 44 cent per Mcf demand rate differential between Rate Schedules P-1 and G-1. This difference is based on the premise that Rate Schedule P-1

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[19] *Texas Eastern Transmission Corp.*, 37 FERC ¶ 61,260 (1986). (Texas Eastern).

[20] *Wyoming Interstate Co., Ltd.*, 34 FERC ¶ 61,340 (1986); *Natural Gas Pipeline Co.*, 28 FERC ¶ 61,174, at p. 61,329 (1984); and *Tennessee Gas Pipeline Co.*, 26 FERC ¶ 61,381, at p. 61,848 (1984).

customers own substantial transmission facilities and therefore it costs CIG less to provide Rate Schedule P-1 service than to provide Rate Schedule G-1 service for those customers without substantial transmission facilities.[21] This difference should also be reflected in the overrun service provided to these customers by CIG which may be accomplished by basing the EX-1, 100 percent load factor rate for those customers with transmission facilities on Rate Schedule P-1 and, for those customers without substantial transmission facilities, the overrun rate will be based on the G-1 Rate Schedule.

Minimum Bill to Natural

In Opinion No. 290, the Commission prospectively eliminated CIG's fixed cost minimum bill under CIG's Rate Schedules F-1 and H-1 for service to Natural.[22] CIG seeks rehearing and argues that the Commission erred in eliminating its minimum bill. Natural seeks rehearing and argues that the Commission erred by not eliminating the minimum bill retroactively to September 28, 1985, the effective date of CIG's rates in this docket. In the alternative, Natural contends that CIG should not be allowed to recover both the Rate Schedule H-1 demand charge it instituted in the instant filing and its fixed cost minimum bill for the period from September 28, 1985, until the date the minimum bill is eliminated. Natural asks that CIG's demand charge become effective prospectively, and that CIG refund the demand charges allocated from Natural between September 28, 1985, and the effective date of CIG's compliance rates.

In Opinion No. 290, the Commission agreed with CIG that the burden rested on Natural and the staff to prove that CIG's minimum bill was not justified. However, the

[21] Exhibit No. 50 at p. 29.

[22] While the minimum bill applies to the aggregate F-1 and H-1 contract quantities, deficiencies are billed at the rate stated in Rate Schedule F-1.

Commission also stated that, under *Transwestern Pipeline Co.*,[23] the burden of going forward to justify retention of the minimum bill had shifted to CIG in light of the minimum bill's anticompetitiveness.[24] The Commission found that CIG did not meet the Commission's applicable criteria for justification of a minimum bill.

CIG argues that the Commission improperly relied on *Transwestern* to switch the burden of proof to CIG because *Transwestern* issued after the close of the record and the filing of briefs in this case. In addition, CIG asserts that, in any event, there was no showing of anticompetitiveness. The Commission disagrees on both points. First, in *Transwestern*, the Commission did not create a new policy with respect to burden of proof. The Commission merely described the nature of its existing policy as applied in *Transwestern*. Second, the Commission's statement in *Transwestern* did not shift the burden of proof with respect to the lawfulness of a minimum bill. The Commission clearly provided that the burden of persuasion was on the challenging parties and described the circumstances whereby a challenger would meet its

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[23] 32 FERC ¶ 61,009 (1985), *reh'g denied,* 36 FERC ¶ 61,175 (1988), aff'd, 820 F.2d 733 (5th Cir. 1987).

[24] *See Transwestern Pipeline Co.,* 36 FERC at pp. 61,439-40, where the Commission stated:

> The burden of persuasion is on the parties challenging the minimum bills and remains there. The initial burden of producing evidence is also on these parties. They satisfy this burden by showing that the inclusion of a minimum bill in Transwestern's rate schedules will cause competitive harm. Once this is shown the burden of production shifts to Transwestern to justify retaining its minimum bills by showing that they are necessary to achieve an objective meriting recognition under the antitrust laws or the Natural Gas Act. In Opinion No. 238 we found that the "probable consequence" of including a minimum bill in Transwestern's rate schedules would be to adversely affect competition. Accordingly, it was incumbent on Transwestern to justify retaining its minimum bills. (Footnotes omitted).

burden unless the minimum bill's proponent was able to justify its retention. Third, the burden properly shifted to CIG in light of testimony that minimum bills are anticompetitive [25] and CIG's admission that it is in a "gas oversupply situation." [26] In addition, there was no unfairness for "CIG was well aware that its minimum bill was in issue and submitted evidence on the issue." [27]

CIG also argues that it met its burden of justifying retention of its minimum bill under the applicable criteria. The three factors which generally justify a minimum bill are:

> First, a minimum bill may be justified as a means of protecting the pipeline against the risk of not recovering the fixed costs in the commodity component. Second, a minimum bill may be justified as a means of protecting full requirements customers from bearing a disproportionate share of the fixed costs resulting from swings off the system by partial requirements customers. And third, a minimum bill may be justified as a means of protecting customers from take-or-pay liabilities the pipeline might otherwise incur.[28]

The Commission found that CIG did not meet those factors. It stated:

> CIG does not meet the first justification because under its modified fixed-variable rate design method a minimum bill to assure recovery of fixed costs is unnecessary. The Commission also finds that CIG does not meet the second justification because the benefits to ratepayers of placing the pipeline at risk for the production and gathering and limited transmission

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[25] Ex. 140 at pp. 10-11.

[26] Brief on Exceptions at p. 20.

[27] 41 FERC at p. 61,465, citing Ex. 50.

[28] *Transwestern Pipeline Co.*, 32 FERC at p. 61,031.

> and storage costs here involved outweigh the potential detriment of shifting those costs to full requirements customers. In addition, the Commission observes that CIG may compete in the transportation arena to recapture any lost sales to Natural and may take other steps to price its gas competitively. Last, the Commission finds that CIG has not met the third justification because it has shown no specific connection between its minimum bill and its take-or-pay obligations. Accordingly, the Commission shall eliminate CIG's minimum bill.[29]

CIG argues that it meets the first test because of the large number of fixed costs in its commodity component under the MFV method as opposed to its filed *Seaboard* rate design method.[30] It adds that its risk of not recovering fixed costs is increased by its need to discount its self-implementing transportation rates. CIG misses the point. The Commission has found that under MFV a minimum bill is unnecessary to assure recovery of fixed costs in the commodity charge because the type of costs included therein (return, taxes, production and gathering) should be at risk.[31] The magnitude of those costs and the discounting of rates are simply irrelevant to the first test. CIG also argues that the Commission's "benefits" analysis under the second test foists $15 million of fixed costs onto CIG and that by placing those costs at risk the Commission has violated the first test. The Commission disagrees that it has somehow violated the

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[29] 41 FERC at p. 61,466. (Footnotes omitted).

[30] The *Seaboard* method is named after *Atlantic Seaboard Corp.*, 11 FPC 43 (1952). CIG states that under Opinion No. 290, approximately $125 million in fixed costs out of a total non-gas cost of service of $186.5 million will be included in its commodity charge. CIG's figure includes fixed production and gathering costs.

[31] *See Transcontinental Gas Pipe Line Corp.*, 40 FERC ¶ 61,188, at p. 61,590 (1987), for a discussion of the rationale that fixed costs in the commodity charge should be at risk.

first test because, as stated, the $15 million represents costs that the Commission believes should be at risk.[32] CIG also maintains that its ability to recapture the lost Natural sales is not supported by the record. The Commission did not rely on this rationale but merely observed that CIG might be able to compete for more business. In any event, the Commission sees no reason why CIG's need to compete for business in its markets (whether or not they are stable or shrinking as claimed by CIG) requires the protection of its revenues as opposed to the opportunity to earn them.[33] Last, CIG argues that it meets the third test because "clearly the gas supply that [it] acquired and maintains for the benefit of [Natural] will either not be taken or be taken only at dramatically reduced levels."[34] While CIG refers to its discontinuance of gas purchases and its minimum bill and take-or-pay exposure and to Natural's decision not to take gas from CIG, CIG has not referred to any record evidence that Natural's cutbacks caused or will cause particular minimum bill or take-or-pay obligations to be incurred.[35] The Commission concludes that CIG's minimum bill under its

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[32] The $15 million in CIG's minimum bill to Natural represents fixed production and gathering costs and should be at risk. *Transwestern*, 820 F.2d at 742; 41 FERC at p. 61,466, 40 FERC at p. 61,590.

[33] *Id.*, 820 F.2d at 742. The Commission notes that CIG did not specifically claim in its rehearing request that its minimum bill is needed to protect full requirements customers from bearing a disproportionate share of the fixed costs.

[34] Request for Rehearing at 9.

[35] For example, as observed by Natural's expert witness, "CIG's customers other than Natural have reduced their takes." Ex. 140 at 15. In addition, CIG's minimum bill is not designed to remedy solely its take-or-pay problem. *See Mississippi River Transmission Corp. v. FERC*, 759 F.2d 945 (D.C. Cir. 1985). Under its minimum bill, Natural could incur minimum bill charges even if CIG has incurred no take-or-pay liabilities.

Rate Schedules F-1 and H-1 for service to Natural is unjust and unreasonable, and should be eliminated.[36]

As stated above, Natural argues that the Commission's decision to eliminate CIG's minimum bill should be applied retroactively to the date the rates here took effect or, in the alternative, that CIG's demand charge under Rate Schedule H-1 should be instituted prospectively.[37] In support of its position, Natural points to other cases where the Commission eliminated minimum bills retroactively. Those cases involved the Commission's policy of relating the elimination of a fixed cost minimum bill to the effective date of the MFV rate design method.[38] Here, the Commission has imposed the MFV rate design method prospectively.[39] Hence, the Commission believes that it is appropriate for CIG's minimum bill to be eliminated prospectively.[40] The Commission also concludes that it is

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[36] CIG reiterates its claim that the Commission's order in *Colorado Interstate Gas Co.*, 27 FERC ¶ 61,315 (1984), constitutes *res judicata* here. The Commission denies rehearing and repeats:

> In that order, the Commission directed "the staff to consider the proper level of fixed cost recovery for CIG's minimum commodity bill in CIG's next section 4 rate case." 27 FERC at p. 61,583. Such a level includes a zero level, that is, no minimum bill.

41 FERC at p. 61,469, n. 136. Moreover, CIG's change to the MFV rate design method is a circumstance which makes *res judicata* inapplicable.

[37] *Distrigas of Massachusetts Corp.*, 41 FERC ¶ 61,205 (1987); *Transcontinental Gas Pipe Line Corp.*, 40 FERC ¶ 61,188 (1987); *East Tennessee Natural Gas Co.*, 40 FERC ¶ 61,201 (1987).

[38] *Id.*

[39] 41 FERC at p. 61,469 n. 137. No party has sought rehearing of the Commission's decision to apply the MFV method prospectively.

[40] Natural also refers to the Commission's retroactive elimination of the inclusion of variable costs in its minimum bill to Natural. *Colorado Interstate Gas Co.*, 27 FERC ¶ 61,315 (1984), *aff'd*, 791 F.2d 803 (10th Cir. 1986), *cert. denied*, 107 S. Ct. 907 (1987). The Commission believes that the involvement here of fixed costs as

appropriate for CIG's Rate Schedule H-1 demand charge to be effective on September 28, 1985. The reason the Commission has not allowed the recovery of demand charges and minimum bills at the same time is that this would permit the recovery of fixed costs associated with transmission by both mechanisms. Here, however, CIG's minimum bill is calculated under Rate Schedule F-1 and does not include any fixed costs associated with transmission.

The Commission denies both CIG's and Natural's rehearing requests.

Rate Schedule H-1 Demand Charge Rate Adjustment or Credit

As stated above,[41] CIG has had the long standing practice of providing a demand charge differential between its Rate Schedule P-1 (pipeline customers) and its Rate Schedule G-1 (pipeline customers) and its Rate Schedule G-1 (distributor customers) whereby the former customers pay a lower demand charge than the latter customers.[42] Prior to the filing in the instant proceeding, CIG gave Natural the benefit of the differential in its one-part H-1 rate for Natural. In the instant filing, CIG proposed to eliminate the demand charge credit for Natural. The ALJ concluded that CIG had not shown that elimination of the credit was just and reasonable. In Opinion No. 290, the Commission affirmed and adopted the ALJ's decision. CIG seeks rehearing.

In Opinion No. 241, the Commission found that CIG's credit was warranted by the delivery point to Natural

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opposed to variable costs is a sufficient distinction for it to decline to exercise its discretion to apply Opinion No. 290 retroactively. This will ensure that CIG will not underrecover those fixed costs.

[41] *See also* the discussion under the heading Rate Schedule Ex-1, *supra* with respect to the demand charge credit.

[42] The present differential is 44 cents per Mcf.

and Natural's facility investment.[43] CIG argues that elimination of the credit is now warranted because Natural has shifted from a base load type of customer at a high load factor to a peaking or standby type of customer at a low load factor. In its Brief Opposing Exceptions, Natural contended that the demand charge credit should be retained because neither of the two justifications—delivery point or facility investment—have changed in this docket. Natural added that CIG has not related the alleged changes in load characteristics to the level of the demand charge credit or the costs incurred to serve Natural.

The Commission reaffirms its conclusion that CIG has not justified the elimination of the demand charge credit. Natural's changed purchasing patterns do not affect the fact that in contrast to CIG's city-gate customers. Natural has substantial facilities for transporting the gas purchased from CIG. Natural would use those facilities whether it buys principally for peak or for base usage. Accordingly, CIG's rehearing request is denied.

Throughput

In Opinion No. 290, the Commission adjusted CIG's proposed test period sales and sales displacement transportation volumes of 215.9 Bcf upward to reflect 14.7 Bcf for sales to Cominco and 6.6 Bcf to eliminate CIG's correction for colder-than-normal weather during the base period. CIG seeks rehearing.

CIG argues that the addition of the Cominco volumes was improper and results in unreasonably high volume levels (236.5 Bcf) in light of ts experienced levels of 179.4 Bcf for the first year of the rates here. CIG asks

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[43] *Public Service Company of Colorado v. Colorado Interstate Gas Co.*, 32 FERC ¶ 61,250, at p. 61,594 (1985). CIG delivers gas to Natural at an interconnection between CIG's mainline and Natural's mainline.

the Commission to exclude the Cominco sales. The Commission adheres to its view that CIG must include the Cominco sales and repeats that "CIG's uncertainty as to whether it would retain Cominco's load is not enough to warrant its exclusion from CIG's volume projections. The fact that it later lost other sales is irrelevant to the Cominco load issue." [44]

The Commission excluded CIG's weather adjustment because "[t]he weather is not predictable enough so as to justify an adjustment to the test period data under the known and measurable standard for test period adjustments." [45] CIG argues that its analysis of actual long term data showed that its 1984 test year was eight percent colder than normal and its 1985-1986 fiscal year was 6.5 percent warmer than normal. It states that "[c]learly the weather is variable, and an adjustment was proper in order to reflect reasonable and normal weather conditions. Thus, CIG's adjustment was known and measurable with reasonable accuracy." [46] Last, CIG states that "test period adjustments for weather are routinely made in rate filings." [47] CIG cites no case for that proposition. CIG's weather adjustment was improper because an eight percent variation in temperature is not so atypical as to warrant rejecting the test year volume levels.[48] Therefore, as the proponent of such weather adjustments, CIG has failed to show that the weather was so abnormal as to render the test year volume levels unrepresentative. Accordingly, CIG's rehearing request with respect to throughput is denied.

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[44] 41 FERC at p. 61,462. CIG did not, in fact, lose the Cominco load. 35 FERC at p. 65,144.

[45] 41 FERC at p. 61,461.

[46] Request for Rehearing at 62.

[47] *Id.*

[48] *See Alabama-Tennessee Natural Gas Co.*, 40 FERC ¶ 61,244, at p. 61,813 (1987).

The Commission orders:

(A) The requests for rehearing and clarification are granted and denied as set forth in this order.

(B) CIG shall permit customers renominations as discussed in the text above, within 30 days of the date of this order, and shall file to reflect any such renominations within 45 days of the date of this order.